No. 112

In the Supreme Court of the United States

October Term, 1926.

275
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AETNA INSURANCE COMPANY, AGRICULTURAL INSURANCE COMPANY, ALLIANCE INSURANCE COMPANY OF PHILADELPHIA ET AL., *Petitioners,*

vs.

BEN C. HYDE, Superintendent of the Insurance Department of the State of Missouri, *Respondent.*

PETITION FOR WRIT OF CERTIORARI.

CHARLES E. HUGHES,
ROBERT J. FOLONIE,
WILLIAM S. HOGSETT,
JOHN S. LEAHY,
ASHLEY COCKRILL
Counsel for Petitioners.

In the Supreme Court of the United States

October Term, 1926.

Aetna Insurance Company, Agricultural Insurance Company, Alliance Insurance Company of Philadelphia, American Alliance Insurance Company, American Central Insurance Company, American Eagle Fire Insurance Company, American Insurance Company of Newark, Assurance Company of America, Atlas Assurance Company, Automobile Insurance Company, Abeille Fire Insurance Company of Paris, Boston Insurance Company, British-American Assurance Company, British General Insurance Co. of London, Eng., Buffalo Insurance Company, Bankers & Shippers Fire Insurance Company, California Insurance Company, Caledonian Insurance Company, Camden Fire Insurance Association, Century Insurance Company, Ltd., Citizens Insurance Company, City of New York Insurance Company, Central States Fire Insurance Company, Cleveland National Fire Insurance Company, Colonial Assurance Company, Columbia Insurance Company, Commercial Union Assurance Company, Ltd., Commercial Union Fire Insurance Company, Commonwealth Insurance Company of New York, Concordia Fire Insurance Company, Connecticut Fire Insurance Company, Continental Insurance Company, County Fire Insurance Company, Detroit Fire & Marine Insurance Company, Dubuque Fire & Marine Insurance Company, Eagle Star & British Dominion's Insurance Company, Ltd., Employers Fire Insurance Company, Equitable Fire & Marine Insurance Company, Federal Insurance Company, Fidelity-Phenix Fire Insurance Company, Fire Association of Philadelphia, Firemen's Fund Insurance Company, Firemen's Insurance Company of Newark, N. J., Franklin Fire Insurance Company, General Fire Assurance Company, Girard Fire & Marine Insurance Company, Glens Falls Insurance Company, Globe & Rutgers Fire Insurance Company, Granite State Fire Insurance Company, Great American Insur-

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ance Compnay, Great Lakes Insurance Company, Hanover Fire Insurance Company, Hartford Fire Insurance Company, Home Insurance Company, Home Fire & Marine Insurance Company, Guaranty Fire Assurance Corporation, Imperial Assurance Company, Insurance Company of North America, Insurance Company State of Pennsylvania, Importers & Exporters Insurance Company, Liverpool & London & Globe Insurance Company, London Assurance Corporation, Chicago Fire and Marine Insurance Company, Excelsior Insurance Company, Union Marine Insurance Company, Limited, Equity Fire Insurance Company, Liberty Fire Insurance Company, America Union Insurance Company, East and West Insurance Company, The Eagle Fire Company, London & Lancashire Fire Insurance Company, Ltd., London & Scottish Assurance Corporation, Ltd., Law Union & Rock Insurance Company, Ltd., Maryland Motor Car Insurance Company, Marine Insurance Company, Ltd., Marquette National Fire Insurance Company, Massachusetts Fire & Marine Insurance Company, Mechanics Insurance Company of Philadelphia, Mechanics & Traders Insurance Company, Mercantile Insurance Company of America, Merchants Fire Assurance Corporation, Michigan Fire & Marine Insurance Company, Milwaukee Mechanics Insurance Company, Minneapolis Fire & Marine Insurance Company, National Ben Franklin Fire Insurance Company, National Fire Insurance Company of Hartford, National Liberty Insurance Company of America, National Union Fire Insurance Company, Nationale Insurance Company of Paris, Netherlands Fire & Life Insurance Co. of The Hague, Newark Fire Insurance Company, New Brunswick Fire Insurance Company, New Hampshire Fire Insurance Company, New Jersey Insurance Company of New Jersey, Niagara Fire Insurance Company, North British & Mercantile Insurance Company, North River Insurance Company, Northern Assurance Company, Ltd., Northern Insurance Company, Northwestern National Insurance Co., Norwich Union Fire Insurance Society, Ltd., Old Colony Insurance Company, Orient Insurance Company, Pacific Fire Insurance Company, Palatine Insurance Company, Ltd., Patriotic Assurance Company, Ltd., Pennsylvania Fire Insurance Company, Phenix Fire Insurance Company of Paris,

Phoenix Assurance Company, Ltd., Phoenix Insurance Company of Hartford, Providence-Washington Insurance Company, Queen Insurance Company, Reliance Insurance Companay of Philadelphia, Rhode Island Insurance Company, Royal Exchange Assurance Company, Ltd., Royal Insurance Company, Ltd., Safeguard Insurance Company, Scottish Union & National Insurance Company, Security Insurance Company of New Haven, Springfield Fire & Marine Insurance Company, St. Paul Fire & Marine Insurance Company, Standard Fire Insurance Company, Standard Fire Insurance Company of New Jersey, State Assurance Company, Sterling Fire Insurance Company, Stuyvesant Fire Insurance Company, Sun Insurance Office of London, Svea Fire & Life Insurance Company, Star Insurance Company of America, Tokio Fire & Marine Insurance Company, Union Assurance Society, Ltd., Union Fire Insurance Company of Paris, United States Fire Insurance Company, United States Merchants & Shippers Insurance Company, Urbaine Fire Insurance Company, Union Insurance Society of Canton, Ltd., Western Assurance Company, United Firemen's Insurance Company, Victory Insurance Company of Philadelphia, Fidelity Union Fire Insurance Company, Great Western Fire Insurance Company, Indemnity Mutual Marine Assurance Company, London & Provincial Marine & General Insurance Company, National Security Fire Insurance Company, Omaha Liberty Fire Insurance Company, Potomac Insurance Company of the District of Columbia, Superior Fire Insurance Companay, Independence Insurance Company, Henry Clay Fire Insurance Company, Philadelphia Fire and Marine Insurance Company, Merchants Insurance Company, Carolina Insurance Company, Twin City Fire Insurance Company, Westchester Fire Insurance Company, Yorkshire Insurance Company and Hudson Insurance Company, *Petitioners*,

vs.

Ben C. Hyde, Superintendent of the Insurance Department of the State of Missouri, *Respondent*.

No. ——.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, The Supreme Court of the United States:

Now come the petitioners above named, and in support of this, their petition for a writ of certiorari to be directed to the Supreme Court of the State of Missouri (the highest court of said state in which a decision could be had) to review a final judgment rendered by said court on the 23rd day of June, 1926, which reversed a judgment of the Circuit Court of Cole County, Missouri, entered on the 22nd day of December, 1924, canceling and setting aside a certain order made by the respondent Ben C. Hyde, Superintendent of the Insurance Department of the State of Missouri, on October 9, 1922 (wherein said respondent ordered a reduction of ten per cent in the rates charged by the stock fire, lightning, hail and windstorm insurance companies doing business in Missouri on fire, lightning, hail and windstorm insurance business written in said state), petitioners respectfully show the following facts:

1. The American Central Insurance Company, Citizens Insurance Company, Liberty Fire Insurance Company and Equity Fire Insurance Company are now and at all the times herein mentioned were corporations organized and existing under the laws of the state of Missouri, and citizens of said state, and authorized to conduct the business of insurance in the state of Missouri and elsewhere. The other above named petitioners are all corporations organized under the laws of various states of the United States other than Missouri, or under the laws of foreign countries, for the purpose of conducting the business of insurance, and are citizens of said states and countries, respectively. The petitioners and each of them are now and were at all such times stock fire insurance companies, duly authorized and licensed to conduct, and

conducting, the business of insurance in the state of Missouri pursuant to the laws thereof. Petitioners comprise all of the stock fire insurance companies licensed to do, and doing, business in Missouri during the years 1917 to 1921, inclusive, and since that period and now.

2. The respondent Ben C. Hyde is now and at all times herein mentioned was the duly appointed, qualified and acting Superintendent of the Insurance Department of the State of Missouri. Respondent is hereinafter referred to as the Superintendent.

3. Each of the petitioners, in order to conduct its business of insurance in the state of Missouri, has been obliged to establish, and has established, local agencies in the various cities and towns throughout said state, at large cost and expense. The agencies so established are of great value to the petitioners respectively, the exact value thereof being dependent upon the number of agencies and the expense of establishing the same. Said value varies from $10,000 in the case of a smaller company having a comparatively small number of agencies, to $50,000 for a large company having agencies in practically all of the towns and cities in the state. The good will of the business of each of the petitioners established in the State of Missouri in each of such local agencies is of great pecuniary value to them respectively. The agencies, agency plants, good will and established business of the petitioners respectively in the State of Missouri constitute property of great value to petitioners respectively.

4. At all times herein mentioned there were in full force and effect the following statutes of Missouri (Sections 6283-6284, Rev. St. Mo. 1919):

> "**Sec. 6283. Superintendent to investigate the reasonableness of rates—authority to order reductions.**—The superintendent of insurance, upon written complaint of any citizen, or upon his own

motion, is hereby empowered to investigate the necessity of a reduction of rates, and if, upon such investigation, it appears that the result of the earnings in this state of the stock fire insurance companies for five years next preceding such investigation shows there has been an aggregate profit therein in excess of what is reasonable, he shall order such reduction of rates as shall be necessary to limit the aggregate collections by insurance companies in this state to not more than a reasonable profit. Any reduction ordered by the superintendent of insurance shall be applied, subject to his approval: Provided, that the superintendent of insurance shall designate the class or classes to which the reduction shall be applied if the companies do not, within thirty days from the order of reduction, submit a class or classes which meet his approval. In determining the question of rates and profits in accordance with this article, the superintendent of insurance shall give proper and reasonable consideration to the conflagration liability, both within and without the state.

"**Sec. 6284. Order of superintendent reviewable by court action.**—The orders and directions of the superintendent of insurance, together with his findings or determinations of facts upon which such order or determination is founded, shall be reviewable by a proper action in the courts, and upon such review the entire matter shall be treated and determined *de novo*, but the burden of proof as to the unreasonableness or the injustice of any order made by the superintendent of insurance shall rest upon the party or company appealing from any such order. During the pendency of such action or review each insurance company or other insurer shall not charge any rate or premium in excess of that fixed by the superintendent of insurance."

5. On the 9th day of October, 1922, the Superintendent, pretending to act under said statutes (which

are the only statutes purporting to give him power to reduce rates), made and promulgated an order in writing, whereby he stated that he had made an investigation of the underwriting experience of the stock fire insurance companies in Missouri during the years 1917 to 1921, inclusive, and that such investigation showed that the aggregate profit of said companies upon their Missouri business during said period was in excess of what was reasonable; and the Superintendent in said order directed and ordered a reduction, effective November 15, 1922, of ten per cent in the rates charged by the petitioners on fire, lightning, hail and windstorm insurance business written in the State of Missouri.

6. Thereafter, on November 10, 1922, these petitioners in accordance with said Section 6284, R. S. Mo. 1919, filed in the Circuit Court of Cole County, Missouri, their petition in equity in case No. 4566, entitled *Aetna Insurance Company et al.* v. *Ben C. Hyde, Superintendent of the Insurance Department of the State of Missouri,* to review said rate reduction order. In their said petition these petitioners charged that said rate reduction order, and the various findings and methods of calculating underwriting profit upon which it purported to be based, were, in various respects specified in said petition, unreasonable, confiscatory, unconstitutional and void, and deprived petitioners of their property without due process of law, in violation of Section 1 of the Fourteenth Amendment of the Constitution of the United States. In their said petition petitioners prayed that said rate reduction order be cancelled, set aside and for naught held. Issue was joined in said suit, and the same was by consent of parties referred to a referee, who heard the evidence and in due time filed his report in said Circuit Court containing findings of fact and conclusions of law.

7. In his report the referee found that the experience of the petitioners in the State of Missouri during the five years 1917 to 1921, inclusive, as shown by the evidence, resulted in a loss in their underwriting business of $7,010,200; that if the rate reduction order under review had been in force during that period, it would have imposed upon petitioners an additional loss of $7,134,751; and that the rate reduction order aforesaid was unreasonable, confiscatory and void and should be set aside. Exceptions to said report filed by the Superintendent were by the Circuit Court overruled, and judgment was rendered by said Circuit Court on the 22nd day of December, 1924, approving the referee's report, finding the issues in favor of the petitioners and finding that the rate reduction order was unreasonable, unjust, confiscatory and void, and should be, and the same was, set aside and for naught held.

8. Thereupon the Superintendent appealed from said judgment to the Supreme Court of Missouri. The Supreme Court of Missouri, by a majority opinion, concurred in by four of the seven judges of said court, handed down on May 21, 1926, rendered judgment upholding the rate reduction order, reversing the judgment of the Circuit Court and ordering the proceeding to review said rate reduction order dismissed. Thereafter in due time petitioners filed in the Supreme Court of Missouri their motion for a rehearing, which was overruled by said court on the 23rd day of June, 1926, at which time said judgment of the Supreme Court of Missouri became final.

9. The fundamental questions upon which the case turns, are these:

(a) Did the "earnings" in Missouri of the stock fire insurance companies (the petitioners herein) for the years 1917 to 1921, inclusive, show "an aggregate profit

therein in excess of what is reasonable"? If the profit was not excessive, then under the statute any rate reduction was unauthorized.

(b) If the aggregate profit was excessive, then is the reduction of ten per cent in rates ordered by the Superintendent greater than is "necessary to limit the aggregate collections by insurance companies in this state (Missouri) to not more than a reasonable profit"?

The opinion and judgment of the Supreme Court of Missouri declare the profit was excessive, and sustain the reduction of ten per cent.

10. The opinion finds petitioners' evidence of their premiums, losses and expenses during the test period to be undisputed. The difference between the parties turns upon the legal questions as to the proper method to be employed in calculating profit or loss, and as to the elements of income and outgo properly entering into the same. Petitioners contend that their profit or loss must be calculated upon the basis of premiums earned less losses and expenses incurred, upon which basis the opinion concedes that petitioners sustained an underwriting loss of $7,010,200 during the test period. The opinion, however, rejects the earned and incurred method and holds that the calculation of profit or loss must be based upon premiums received less losses and expenses paid, and must include interest on unearned premiums as underwriting income, and that certain expenses incurred for commissions to agents and war taxes must be eliminated from consideration as outgo.

The conclusions of the majority opinion as to the petitioners' earnings in Missouri during the test period are summarized in the following tabulation appearing in said opinion:

"Premiums (received) 1917-1921			$83,502,181
Add interest on unearned premiums			2,301,132
Total income			$85,803,313
Losses and expenses (paid)		$80,161,057	
Deduct			
Excess commissions in St. Louis	$2,496,715		
Federal Income Tax	542,993		
	$3,039,708		
		3,039,708	
Actual loss and expense		$77,121,349	
			77,121,349
Actual net earnings			$ 8,681,964
If the war tax had not been in operation			628,123
it would have been			$ 9,310,087
If the increase of 1920 had not been in partial effect,			1,084,444
the net earnings would have been			$ 8,225,643"

The opinion finds that a reasonable profit to petitioners during the test period would have been $6,680,169; that the profit found to have been derived was in excess of that; and that the reduction of ten per cent was justified.

11. The petitioners contended in the trial court and in the Supreme Court of Missouri, and aver now, that the methods adopted and the findings made by the Superintendent and approved by the opinion and judgment of said Supreme Court, in the ascertainment of alleged profit, are oppressive, unreasonable, capricious, and fundamentally erroneous; that the rate reduction order, based upon such methods and findings is confiscatory; and that petitioners are thereby deprived of their property without due process of law, in violation of Section 1 of the Fourteenth Amendment to the Con-

stitution of the United States, in the following particulars:

(a) The rate reduction order and the opinion and judgment of the Supreme Court of Missouri base the ascertainment of alleged profit during the five-year test period upon the amount of premiums received less losses and expenses paid by the petitioners, instead of upon the amount of premiums earned less losses and expenses incurred during said period.

The evidence in the case shows, and the opinion finds, that the amount of premiums received in Missouri during the test period was $83,502,181; but that of this amount only $74,813,816 was earned by the petitioners during that period, leaving a balance of $8,688,365 of premiums received, but not earned, during said period.

Although the ultimate purpose of the inquiry was to ascertain the amount of the petitioners' "earnings" in Missouri during the test period, the rate reduction order and the opinion of the Supreme Court of Missouri consider and treat as a part of the petitioners' earned income during the test period, that portion of the premiums received which admittedly was not earned during said period; and include in the tabulation of alleged profit the full amount of premiums received ($83,502,181), including both earned and unearned premiums; and thereby include $8,688,365 of premiums which were not earned by petitioners during the test period.

The rate reduction order and the opinion of the Supreme Court of Missouri, in so treating $8,688,365 of unearned premiums as earned, and in treating all premiums received ($83,502,181) as if earned (in the face of the admitted fact that $8,688,365 thereof were not earned), adopt an oppressive, capricious, unreasonable, fundamentally erroneous and confiscatory method of calculation; and by the reduction in rates based thereon petitioners are deprived of their property without

due process of law, in violation of Section 1 of the Fourteenth Amendment of the Constitution of the United States.

The evidence shows and the opinion finds that petitioners' losses and expenses paid in Missouri in the test period were $80,161,057, but that their losses and expenses incurred in said period were $81,824,016, there being a balance of $1,662,959 of losses and expenses incurred (but not paid) by petitioners during said period; for which losses and expenses petitioners' liability was firmly fixed and established during said period.

The rate reduction order and the opinion of the Court in ascertaining petitioners' profit or loss during the test period, refuse to include said $1,662,959 of losses and expenses incurred (but not paid) during said period, in spite of the fact that said losses and expenses were actually incurred by petitioners and their liability therefor was definitely and firmly fixed during the test period. In so holding, the rate reduction order and the opinion of the court adopt an oppressive, capricious, unreasonable, fundamentally erroneous and confiscatory method of calculation; and by the reduction of rates based thereon petitioners are deprived of their property without due process of law, in violation of Section 1 of the Fourteenth Amendment of the Constitution of the United States.

(b) The rate reduction order and the opinion of the Supreme Court of Missouri treat all premiums received during the test period ($83,502,181) as earned income of the petitioners, and thereby treat unearned premiums as the unqualified property of the petitioners, held for the benefit of their respective stockholders. Notwithstanding that holding of the opinion, the opinion nevertheless takes into consideration, in its tabulation of petitioners' alleged underwriting profit, the sum of $2,301,132, declared by the opinion to have been derived by

petitioners as interest on unearned premiums. The opinion thereby takes interest derived from the investment of petitioners' assets and applies the same toward a reduction of rates for underwriting.

The evidence shows, and the opinion concedes, that the petitioners have two separate and distinct activities, to-wit, their underwriting activity and their investment activity, each of which is productive of a profit or a loss.

The rate reduction order and the opinion treat, as an element entering into the ascertainment of underwriting profit or loss, the interest earnings derived from the investment of unearned premiums (held by the opinion to be the unqualified property of the petitioners), and by such holding the petitioners are compelled to do their underwriting business at rates of premium which will result in actual loss, or will yield less than a reasonable profit, on the fundamentally erroneous theory that by the application of interest earnings aforesaid such loss or deficiency in profit may in whole or in part be overcome.

The rate reduction order and the opinion, in applying investment income ($2,301,132 interest on unearned premiums) toward a reduction of rates of premium for underwriting, adopt a method of calculating the petitioners' profit or loss which is oppressive, capricious, unreasonable, fundamentally erroneous and confiscatory; and by the reduction of rates based thereon the petitioners are deprived of their property without due process of law, in violation of Section 1 of the Fourteenth Amendment of the Constitution of the United States.

(c) In ascertaining the alleged profit of the petitioners in Missouri during the five-year test period, the opinion of the Supreme Court of Missouri deducts from the petitioners' expenses the sum of $2,496,715 excess commissions (to-wit, commissions paid by petitioners to their

agents in the city of St. Louis upon a scale higher than that in force in the balance of the state), said deduction being based upon the alleged ground that said excess commissions were unreasonable expenses.

The evidence shows that the excess commissions were actually paid by petitioners during the test period to their St. Louis agents, and were a necessary part of their expenses. The evidence shows that petitioners' St. Louis agents, by reason of the higher cost of operating insurance agencies in St. Louis as compared with the cost in smaller cities and towns of the state, have for many years exacted of petitioners a higher scale of commissions than are paid elsewhere in Missouri; and that this increased scale of commissions is an expense which petitioners are of necessity compelled to pay if they do business in St. Louis, and are forced upon the respective petitioners by competition.

The opinion of the court below, in ascribing the power to the Superintendent to exclude $2,496,715 excess commissions in St. Louis, and in itself excluding that sum, in the ascertainment of petitioners' profit or loss in Missouri during the test period, holds in substance that the Superintendent may substitute his judgment for the honest discretion of the directors of the petitioner companies respecting the necessity and reasonableness of these expenses, and may invade the general inherent right of the petitioners to conduct and manage their own business in their own way; and adopts a method of calculating petitioners' underwriting profit which is arbitrary, capricious, oppressive, unreasonable, fundamentally erroneous and confiscatory; and by the reduction of rates based thereon the petitioners are deprived of their property without due process of law, in violation of Section 1 of the Fourteenth Amendment to the Constitution of the United States.

(d) In determining whether the ten per cent reduction in rates was reasonable or unreasonable, the opinion of the Supreme Court of Missouri deducts from petitioners' expenses during the test period the sum of $628,123 war tax paid by petitioners on Missouri premiums during said period.

The evidence shows that the petitioners actually paid during the test period the sum named as a war tax, imposed by the federal government on premiums derived by petitioners in Missouri during said period. This war tax was a necessary operating expense which petitioners were compelled to, and did pay, as a necessary incident to their doing business in Missouri during the test period.

The only ground assigned by the opinion below for excluding this item of expense from consideration is that the law imposing the war tax on premiums was no longer in operation at the time the reduction order was made, and that therefore the war tax paid on Missouri premiums in the five-year period should not be "listed as an expense in fixing future rates."

The controlling statute under which the Superintendent acts in ordering a reduction of rates (Section 6283, R. S. Mo. 1919) expressly limits the inquiry to the actual result of petitioners' operations in Missouri during the five-year test period. Under said statute neither the Superintendent nor the Supreme Court of Missouri has the right to assume or conjecture that during the years following the five-year test period there may not be taxes as great or greater than the war tax on premiums imposed during the test period.

The holding in the opinion that said $628,123 in war taxes on Missouri premiums should be deducted from petitioners' expenses of the test period, in fixing future rates, is capricious, oppressive, unreasonable, fundamentally erroneous and confiscatory; and by the reduc-

tion of rates based thereon petitioners are deprived of their property without due process of law, in violation of Section 1 of the Fourteenth Amendment of the Constitution of the United States.

(e) The opinion of the Supreme Court of Missouri holds that 8% of $83,502,181 premiums received, or $6,680,169, would be a reasonable profit to petitioners for the test period. But in so holding the opinion fails to take account of proper elements of income and outgo hereinbefore mentioned, and fails to take into account the unearned premium reserve which petitioners are compelled by the laws of Missouri to set aside out of premiums received. The average amount of the unearned premium reserve for the test period was $12,717,016, of which 60%, or $7,630,209, was set aside out of premiums received, and the remaining 40% was drawn from petitioners' free surplus. The opinion fixes 8% of premiums received, or $6,680,169, as the amount of a reasonable profit for the test period, but ignores and wholly fails to take account of the fact that more than that sum, or $7,630,209, was set aside out of premiums received as part of the unearned premium reserve during the test period. Upon the volume of business during the test period, the 8% of premiums received, allowed by the opinion as a reasonable profit, was, in fact, more than consumed by that portion of the unearned premium reserve drawn from premiums received, leaving no profit whatever in fact remaining.

The aforesaid method of the opinion in arriving at the amount of a reasonable profit, without making any allowance for the unearned premium reserve, was and is unreasonable, arbitrary, capricious, fundamentally erroneous and confiscatory; and by the reduction of rates based thereon petitioners are deprived of their property without due process of law, in violation of Section 1

of the Fourteenth Amendment of the Constitution of the United States.

(f) Section 6283, Revised Statutes of Missouri 1919, as now construed and applied by the Supreme Court of Missouri in the instant case, authorizes the Superintendent, in the determination of the stock fire insurance companies' profit or loss in Missouri preliminary to the making of an order reducing rates of premium to be charged by said companies in Missouri, to determine said profit or loss upon the basis of premiums received less losses and expenses paid, instead of premiums earned less losses and expenses incurred by said companies during the five-year test period; and to include as part of said companies' income in Missouri the interest derived by them on their unearned premiums; and to deduct from their expenses actually incurred and paid in Missouri during the test period such expenses as the Superintendent may regard as unreasonable; and to deduct from such expenses all war taxes on premiums incurred and paid by said companies during the test period; and to fix as the amount of a reasonable profit eight per cent of premiums received, without making any allowance for the fact that a large portion of premiums received are set aside in the unearned premium reserve. Said Sec. 6283, R. S. Mo. 1919, as so construed by said Supreme Court, is in each of the respects just stated unconstitutional and void and in violation of Section 1 of the Fourteenth Amendment of the Constitution of the United States, in that in each of said respects it is unreasonable and confiscatory and deprives the petitioners of their property without due process of law.

12. Each and all of the federal questions referred to in the preceding subdivisions lettered (a), (b), (c), (d) and (f) of Section 11 of this petition were specially set up and asserted by petitioners in their original petition

and throughout the trial in the Circuit Court, and in their briefs and motion for rehearing in the Supreme Court of Missouri. The federal question referred to in the preceding subdivision lettered (e) of Section 11 of this petition arose for the first time in the opinion below, and was specially set up and asserted by petitioners in their said motion for rehearing. All of said federal questions respectively were raised by petitioners at the earliest possible stage in the proceeding below. Each of the foregoing rights, privileges and immunities were specially set up and claimed by petitioners under the due process clause of the first section of the Fourteenth Amendment of the Constitution of the United States, and by the opinion and final judgment of the Supreme Court of Missouri rendered, each and all of said federal claims so made by petitioners have been denied.

13. The opinion below finds that after applying the ten per cent reduction the petitioners, on the volume of business in the test period, would earn a profit of $7,287,209; and that a reasonable profit on such volume of business would be $6,680,169. Therefore, the profit which the opinion says petitioners would earn, with the ten per cent reduction applied, is only $607,040 in excess of the amount which the opinion finds would have been a reasonable profit.

The opinion sustains the rate reduction order, by this margin of $607,040, only by including as income $8,688,365 of premiums received (but not earned) during the test period, and by rejecting $1,662,959 of losses and expenses actually incurred (but not paid) during the test period, and by including as underwriting income $2,301,132 interest on unearned premiums, and by rejecting $2,496,715 excess commissions in St. Louis and $628,123 war tax on premiums actually incurred and paid as expenses during the test period, and by wholly

ignoring the fact that petitioners during the test period were required to set aside unearned premium reserves in the average sum of $12,717,016.

If (as petitioners aver) the opinion below erroneously includes any one of said items as income, or erroneously excludes from consideration any one of said items of outgo, or erroneously fails to take account of the unearned premium reserve requirements, then upon the facts found by the opinion the result reached by the opinion is wrong, and the rate reduction order is unreasonable and confiscatory, and deprives petitioners of their property without due process of law, in violation of the first section of the Fourteenth Amendment to the Constitution of the United States.

14. There are these special and important reasons why this Honorable Court should grant the petitioners a review of said judgment by writ of certiorari:

(a) If the rate reduction order here involved be allowed finally to stand, the petitioners will be subjected to ruinous loss, in that they will be required to return to policy holders in the State of Missouri approximately $7,000,000, this sum representing the difference between the rates at which policies have been issued since November 15, 1922, and the rates fixed by the reduction order (petitioners, under stipulation, having continued to collect premiums at the rates in force prior to the making of the rate reduction order, bond being given to refund the excess if the order should be finally sustained), and petitioners will be compelled in the future either to do business in Missouri at ruinous and grossly confiscatory rates of premium, or to cease doing business in the State of Missouri and thereby to lose their agencies, agency plants, good will and business established in said state; and in either case petitioners will be deprived of their property without due process of

law, in violation of Section 1 of the Fourteenth Amendment of the Constitution of the United States.

(b) The foregoing federal questions are questions of substance, and of great public importance, not only in the State of Missouri, but in numerous other states, which have statutes authorizing the regulation of insurance rates. The Supreme Court of Arkansas has decided that underwriting profit shall be calculated on the basis of premiums earned less losses and expenses incurred (*Bullion* v. *Aetna Insurance Company*, 151 Ark. 519, 237 S. W. 717), while in the instant case the Supreme Court of Missouri has decided the same question in the opposite way. That question as well as all the other questions presented in this petition for certiorari are federal questions, and are questions of vital importance in the regulation of insurance rates by the several states. Said questions have not heretofore been, but should be, authoritatively and finally settled and determined by this court.

(c) The Supreme Court of Missouri has decided said federal questions in a way not in accord with the applicable decisions of this court upon analogous questions.

15. This petition for review on writ of certiorari is accompanied by a certified transcript of the record in the court below, including the proceedings in the court to which the writ is asked to be directed.

Wherefore, your petitioners pray that a writ of certiorari issue out of and under the seal of this Honorable Court, directed to the Supreme Court of Missouri, commanding that court to certify said cause to this court for review and determination, as provided by paragraph (b) of Section 237 of the Judicial Code, as amended by the Act of February 13, 1925; and that your petitioners may have such other and further relief

in the premises as to this court may seem appropriate and in conformity with said Act.

And your petitioners will ever pray.

Charles E. Hughes — CHARLES E. HUGHES,
Robert J. Folonie — ROBERT J. FOLONIE,
William S. Hogsett — WILLIAM S. HOGSETT,
John S. Leahy — JOHN S. LEAHY,
Ashley Cockrill — ASHLEY COCKRILL,
Counsel for Petitioners.

State of Missouri, County of Jackson—ss.

William S. Hogsett, being duly sworn, upon oath says that he is agent and attorney for the petitioners named in the foregoing petition and makes this affidavit for and on behalf of said petitioners; that he has read the same and knows the contents thereof, and that the facts therein stated are true to the best of his knowledge, information and belief.

William S. Hogsett
.....
Affiant.

Subscribed and sworn to before me this 23rd day of August, 1926.

My commission expires January 7, 1928.

.....
Notary Public within and for Jackson County, Missouri.

No. 6[redacted]112

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WM. R. STANSB
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In the Supreme Court of the United States

October Term, 1926.

AETNA INSURANCE COMPANY, AGRICULTURAL INSURANCE COMPANY, ALLIANCE INSURANCE COMPANY OF PHILADELPHIA, ET AL., *Petitioners,*

vs.

BEN C. HYDE, SUPERINTENDENT OF THE INSURANCE DEPARTMENT OF THE STATE OF MISSOURI, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

CHARLES E. HUGHES,
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ASHLEY COCKRILL,
Counsel for Petitioners.

SMITH-GROVES LAW PRINTING, KANSAS CITY, MO.

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In the Supreme Court of the United States

October Term, 1926.

AETNA INSURANCE COMPANY, AGRICULTURAL INSURANCE COMPANY, ALLIANCE INSURANCE COMPANY OF PHILADELPHIA, ET AL., *Petitioners*,

vs.

BEN C. HYDE, SUPERINTENDENT OF THE INSURANCE DEPARTMENT OF THE STATE OF MISSOURI, *Respondent*.

No. ——.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The majority and minority opinions below are reported in *Aetna Insurance Company* v. *Hyde*, 285 S.W. 65, and are printed at pages 3003-3046 of the record herein.

The Court Has Jurisdiction.

The petitioners, comprising all of the stock fire insurance companies doing business in Missouri (R. 1633, 1919), brought suit in the Circuit Court of Cole County, Missouri, to review a rate reduction order of the respond-

ent Superintendent of Insurance. The suit was a review proceeding authorized by statute. Upon appeal the Supreme Court of Missouri, the highest court of the state in which a decision could be had, rendered judgment on May 21, 1926 (R. 3000) sustaining the rate reduction order. This judgment became final on June 23, 1926, (R. 3075).

Petitioners attacked the rate reduction order as in violation of the due process clause of the Fourteenth Amendment, in that the same is unreasonable and confiscatory, and the methods adopted and findings made in the calculation of petitioners' profit or loss in Missouri for the statutory five year test period (Sec. 6283, R. S. Mo. 1919) are unreasonable, capricious, fundamentally erroneous and confiscatory and operate to deprive petitioners of their property without due process of law, in these respects:

(a) In ascertaining the amount of petitioners' profit or loss, $8,688,365 of premiums which were not earned during the test period are included as income, and $1,162,959 of incurred but unpaid losses and expenses are excluded from consideration as outgo (R. 3034-5, 3007-8). This action and method of calculation were attacked as confiscatory and as a denial of due process (R. 33, 35, 2995-8, 3048-9, 2884-6), but were upheld by the opinion below (R. 3017-23).

(b) Although all premiums received, both earned and unearned, are treated as income, and such unearned premiums are treated as the unqualified property of the petitioners (R. 3017-23, 3044-6), nevertheless $2,301,132 interest derived from the investment of such unearned premiums is also included as underwriting income (R. 3034-5); and thereby earnings from one department of petitioners' business (investment) are applied to a reduction of rates in a separate and distinct department (underwriting). Petitioners attacked this method of calculation as unreasonable and confiscatory and as a denial of due process (R. 33, 35, 590-1, 595-6, 599-600, 372-7, 400-2, 463-4, 468, 469, 491-2, 563, 608-9, 611-13, 614-18,

620-662, 2043, 2047-9, 2052, 2216-17, 2263-4, 2880, 2884-6, 2987-92, 3054-5); but the opinion below nevertheless approved it (R. 3023-8, 3075).

(c) The sum of $2,496,715 so-called excess commissions to St. Louis agents (being commissions based on a scale higher than that obtaining in the remainder of the state) is excluded from expense as unreasonable (R. 3032-3), notwithstanding said expense was actually incurred and paid in good faith as a necessary operating expense. This ruling was attacked by petitioners as an infringement of their inherent right to manage their own business according to their own best judgment, and as a denial of due process (R. 34, 37, 2216-17, 2264, 2986, 2993-5, 3055-7), but the contention was disallowed (R. 3032-3, 3075).

(d) The sum of $628,123 Federal war tax on Missouri premiums is excluded from consideration although that sum was actually incurred and paid as a necessary operating expense. This ruling was attacked as unreasonable and confiscatory and as a denial of due process (R. 34, 37, 2986, 2993-5, 3056), but the contention was disallowed (R. 3034-5, 3075).

(e) The opinion fixes 8% of premiums received, or $6,680,169, as a reasonable profit. The allowance of this amount as a supposed profit, without properly taking account of the elements mentioned in (a) to (d), *supra*, is unreasonable and confiscatory. It also fails to make any allowance for reserves; and in view of the fact that petitioners were compelled by the laws of Missouri to set aside $12,717,000 as the average amount of reserves during the test period (60% of which, or $7,630,209, was drawn from premiums received) the standard of profit fixed by the opinion is unreasonable and confiscatory. This contention was made below (R. 3048, 3060) and was disallowed (R. 3034-5, 3075).

(f) The rating act (Sec. 6283, R. S. Mo. 1919) as construed and applied by the opinion below is confiscatory

and deprives petitioners of their property without due process of law. This point was presented below (R. 35, 37, 621-2, 2216-17, 2263-4), and by the result of the opinion was necessarily disallowed (R. 3034-5).

The foregoing propositions involve Federal questions of substance not heretofore determined by this court, and are of vital importance in Missouri and numerous other states having statutes authorizing the regulation of insurance rates. The court below has decided the questions in a way not in accord with applicable decisions of this court upon analogous questions.

Petitioners base their petition for certiorari upon Sec. 237(b) of the Judicial Code as amended by the Act of February 13, 1925.

The following decisions sustain the jurisdiction of this court to review the judgment below:

Bluefield Company v. *Public Service Commission*, 262 U. S. 679.

Northern Pacific Ry. Co. v. *Department of Public Works*, 268 U. S. 39.

State of Missouri ex rel. Telephone Co. v. *Public Service Commission*, 262 U. S. l. c. 288-289.

Myles Salt Co. v. *Iberia Drainage District*, 239 U. S. l. c. 484.

Ohio Utilities Co. v. *Public Utilities Commission*, 267 U. S. 359.

Vandalia Railroad Co. v. *Schnull*, 255 U. S. 113.

Brooks Scanlon Co. v. *Railroad Commission*, 251 U. S. 396.

Georgia Railway & Power Co. v. *Railroad Commission of Ga.*, 262 U. S. 633.

Galveston Electric Co. v. *Galveston*, 258 U. S. l. c. 399-400.

Interstate Commerce Commission v. *Railroad Company*, 222 U. S. l. c. 547.

Union Tank Line Company v. *Wright*, 249 U. S. 275.

Northern Pacific Ry. Co. v. *North Dakota*, 236 U. S. 585.

Smyth v. *Ames*, 169 U. S. l. c. 540-541.

Minnesota Rate Case, 230 U. S. 352.
Norfolk & Western Ry. Co. v. *Conley*, 236 U. S. 605.
Board of Public Utilities Commissioners v. *New York Telephone Co.*, 46 Sup. Ct. Rep. 363.
Houston v. *Telephone Co.*, 259 U. S. l. c. 323.
Banton v. *Belt Line Railway*, 268 U. S. l. c. 421.

STATEMENT OF THE CASE.

This case presents federal questions of fundamental importance in the regulation of fire insurance rates by the several states. Its pecuniary importance is indicated by the fact that the 10% reduction involved herein amounts to more than $1,500,000 per year, and that if the judgment below is permitted to stand, petitioners, having collected the old rate pending the suit under the security of indemnity bond, will be compelled to pay back to Missouri policyholders approximately $7,000,000 as refund of premiums collected.

We have made this brief as concise as possible to conform to Rule 35, having regard for the size of the 3075 page record and the number and importance of the questions involved.

The petitioners, 157 in number, comprise all of the stock fire insurance companies licensed to do and doing business in Missouri (R. 1633, 1919). Respondent is the Superintendent of the Insurance Department of that state.

The case presents for review an order of the Superintendent promulgated October 9, 1922, directing a reduction of 10% in rates charged by petitioners (R. 27-31, 40). Petitioners brought suit attacking the order. The case was referred to a referee, who found the order confiscatory. His report was confirmed by the trial court, and judgment was rendered in petitioners' favor. Such judgment was reversed and the proceeding ordered dismissed by the Supreme Court of Missouri, which held the reduction order justified (R. 3003). A dissenting opinion was filed, concurred in by two judges, holding the order confiscatory and in violation of the due process clause of the Fourteenth Amendment (R. 3037). It is to review the judgment of the Missouri Supreme Court that this present proceeding is filed.

The rating statute under which the Superintendent purported to act in making his order is as follows (Sec. 6283, R. S. Mo. 1919):

> "**Sec. 6283. Superintendent to investigate the reasonableness of rates—authority to order reductions.**—The superintendent of insurance, upon written complaint of any citizen, or upon his own motion, is hereby empowered to investigate the necessity for a reduction of rates, and if, upon such investigation, it appears that the result of the earnings in this state of the stock fire insurance companies for five years next preceding such investigation shows there has been an aggregate profit therein in excess of what is reasonable, he shall order such reduction of rates as shall be necessary to limit the aggregate collections by insurance companies in this state to not more than a reasonable profit. Any reduction ordered by the superintendent of insurance shall be applied, subject to his approval: Provided, that the superintendent of insurance shall designate the class or classes to which the reduction shall be applied if the companies do not, within thirty days from the order of reduction, submit a class or classes which meet his approval. In determining the question of rates and profits in accordance with this article, the superintendent of insurance shall give proper and reasonable consideration to the conflagration liability, both within and without the state. (Laws 1915, p. 313).

The review proceeding instituted by petitioners was brought pursuant to Section 6284, R. S. Mo. 1919, reading as follows:

> **Sec. 6284. Order of superintendent reviewable by court action.**—The orders and directions of the superintendent of insurance, together with his findings or determinations of facts upon which such order or determination is founded, shall be reviewable by a proper action in the courts, and upon such review the entire matter shall be treated

> and determined *de novo*, but the burden of proof as to the unreasonableness or the injustice of any order made by the superintendent of insurance shall rest upon the party or company appealing from any such order. During the pendency of such action or review each insurance company or other insurer shall not charge any rate or premium in excess of that fixed by the superintendent of insurance. (Laws 1915, p. 313.)"

The petitioners have established agencies in the State of Missouri at great cost. Petitioners' agency relations, good will and established business are of great pecuniary value. (R. 749, 1531-2, 1760-1, 1800, 1802-3.) If the superintendent's order should be sustained, petitioners must either conduct their business in Missouri at rates which they contend are grossly inadequate and confiscatory and will deprive them of all profit, or alternatively they must abandon their Missouri business and thereby lose their agency plants and established business. They contend that in either event they would be deprived of their property without due process (R. 31-32, 2999).

In the Superintendent's order he stated that he had made an investigation of petitioners' underwriting experience in Missouri during the statutory five year test period (in this instance, 1917 to 1921, inclusive), and that such investigation showed petitioners' aggregate profit was in excess of what is reasonable; wherefore the Superintendent ordered a reduction, effective November 15, 1922, of 10% in the rates charged by petitioners on fire, lightning, hail and windstorm insurance business (R. 27-31, 40).

In the suit, seasonably filed to review the order, petitioners charged that the order was in certain respects unreasonable and confiscatory, and deprived petitioners of their property without due process of law, in violation of the Fourteenth Amendment (R. 31-32, 33-35, 37); and prayed that the order be set aside (R. 39).

Issue being joined (R. 40), the case was referred to a referee, the Honorable John I. Williamson, a former judge of the Missouri Supreme Court, who heard the evidence and filed his report (R. 2903), finding that during the test period the petitioners sustained an underwriting loss in Missouri of $7,010,200; and that if the reduction order had been in force during that period it would have imposed an additional loss of $7,134,751 (R. 2942). Upon these findings the referee found the order unreasonable, confiscatory and void (R. 2942-3); his findings were confirmed by the Circuit Court, and judgment was accordingly entered annulling the order (R. 2969-72). The judgment of reversal by the Missouri Supreme Court was concurred in by a bare majority of the court.

The fundamental questions upon which the case turns are these: (a) Did the petitioners' "earnings" in Missouri for the five year test period show "an aggregate profit therein in excess of what is reasonable?" If no excessive profit was earned, then the Superintendent had no power under the statute to reduce rates. (b) If an aggregate profit in excess of what is reasonable was earned, then the Superintendent's power was limited by the statute to such reduction of rates as is "necessary to limit the aggregate collections by insurance companies in this state (Missouri) to not more than a reasonable profit."

The petitioners' evidence as to their premiums, losses and expenses during the test period was during the trial expressly accepted by the Superintendent as correct (R. 2072), and is found by the opinion below to be undisputed. The opinion says: "There seems to be no dispute as to specific facts; the contest arises upon a different interpretation by the respective parties of the facts produced" (R. 3008-9); and further says: "The difference between the state and the plaintiffs arises in the method of ascertaining the amount of the profit realized on the business" (R. 3011). Upon the controlling facts relating

to each point herein there is no dispute. The case turns upon the questions as to the proper method to be employed in calculating profit or loss, and as to the elements of income and outgo properly entering into the same. These are questions of law.

In this connection we call attention to one point to avoid a possible misunderstanding: The opinion states that the petitioners' reports of underwriting experience made annually to the Superintendent were erroneous and untrustworthy (R. 3007). It is very important to note that the figures in evidence upon which the case was tried were not taken from these reports (the so-called "Reports of Underwriting Experience by Classes"), but were assembled and put in evidence from petitioners' books and records. The errors in such reports therefore do not affect the result herein. Incidentally, it is but fair to add that these errors were due to no wrongful intent on the part of petitioners, but to the confessedly incomplete, ambiguous and confusing form in which the report blanks themselves were prepared by the Insurance Department. (R. 1855-1908, 196-7, 380-6, 387-393, 443-6, 535-6, 603-7, 668-9, 675, 2083-5, 2273).

The petitioners contended that their profit or loss during the test period must be calculated on the basis of premiums *earned* less losses and expenses *incurred*. The opinion concedes (R. 3018) that on this basis petitioners sustained an underwriting loss of $7,010,200 during the test period, as follows (R. 3007):

Earned Premiums		$74,813,816
Incurred Losses	48,593,664	
Incurred Expenses	33,230,352	
Incurred losses and expenses combined		81,824,016
Underwriting loss (9% of earned premiums)		$ 7,010,200

The opinion, however, rejects the earned and incurred method and holds that the calculation must be upon the basis of premiums *received* less losses and expenses *paid*, and must include interest on unearned premiums as underwriting income, and that certain expenses must be eliminated from consideration. The opinion says (R. 3034-5):

"We summarize our conclusions as follows:

Premiums (received) 1917-1921		$83,502,181
Add interest on unearned premium		2,301,132
Total income		$85,803,313
Losses and Expenses (paid)	$80,161,057	
Deduct		
Excess commissions in St. Louis	$2,496,715	
Federal income tax	542,993	
	$3,039,708	3,039,708
Actual loss and expense	$77,121,349	77,121,349
Actual net earnings		$ 8,681.964
If the war tax had not been in operation,		628,123
it would have been		$ 9,310,087
If the increase of 1920 had not been in partial effect,		1,084,444
the net earnings would have been		$ 8,225,643"

The court finds that a reasonable profit during the period would have been $6,680,169 (R. 3035), and finding upon its methods of calculation that a greater profit than that was derived, holds the profit unreasonable and the reduction justified (R. 3035).

The *federal questions* presented are as follows:

(a) The petitioners attacked the method of calculating underwriting profit adopted by the rate reduction order and the opinion below. The opinion makes the calculation upon the basis of premiums *received* less losses and expenses *paid*, instead of upon premiums *earned* less losses and expenses *incurred*, during the test period. The amount of premiums received upon policies written during the test period was $83,502,181 (R. 3034); but only $74,813,816 was earned during the test period (R. 3007, and see plaintiffs' Exhibit 1359 at R. 1925), leaving a balance of $8,688,365 of premiums received but not earned during the test period.

Insurance policies are usually written for terms of one, three or five years (R. 251, 206), the average term being two years and seven months. The premium is payable at the beginning of the term (R. 206). A portion of the premium must under the laws of Missouri be immediately set aside in a reserve, denominated the "unearned premium reserve," this portion being fixed by statute at "50% of the gross premiums on all unexpired fire risks that have less than one year to run, and a pro rata of all gross premiums on risks that have more than one year to run" (Sec. 6222, R. S. Mo. 1919, printed in appendix hereto). The purpose of the unearned premium reserve is to take care of future losses and expenses on the policy, or the return of unearned premium in case of cancellation (R. 843, 889-90, 211, 359, 362-3, 697-8, 732, 803, 804-5, 1533, 1630, 1955, 2120). As time goes on, more and more of the premium received becomes earned, and less of it remains unearned, until at the expiration of the policy (or upon payment of a total loss) it all becomes earned (R. 704, 706, 209-10, 230, 477-8).

By the "earned premiums" of a given test period is meant those premiums which pay for the policies or

parts thereof which are in effect during that period, regardless of when written. As applied to a particular policy, the earned premium is that proportion of the whole premium which that part of the policy term falling within the test period bears to the whole term of the policy. The remainder of the premium on such policy is the "unearned premium."

The method adopted in the opinion below is to include as income all premiums received, regardless of whether entirely earned during the test period or not. In point of fact, $8,688,365 of the premiums received were admittedly not earned during the test period, and at the expiration of the period constituted part of the $17,061,209 unearned premium reserve.

Petitioners' losses and expenses *paid* in the test period were $80,161,057 (R. 3034-35), but their losses and expenses *incurred* were $81,824,016 (R. 3007, and see plaintiffs' Exhibit 1359, at R. 1925). So at the end of the period there was a balance of $1,662,959 of incurred but unpaid losses and expenses. Petitioners' liability for this balance of losses and expenses was firmly fixed and established during the test period (R. 1036-38, 1386, 1507). The opinion below refuses to include this sum as outgo, and bases the ascertainment of profit upon losses and expenses paid.

The difference between *expenses* incurred and *expenses* paid is negligible, because expenses are paid substantially as soon as incurred (R. 3019, 708, 765); and in fact a few companies make no effort to distinguish between paid and incurred expenses, but as a matter of convenience calculate their experience on a paid basis so far as *expenses* are concerned (R. 307, 722, 1191). However, the difference between *losses* incurred and *losses* paid may in a given period be substantial and this difference may be either way, depending upon the experience of the last sixty days of the period (R. 236). Losses are pay-

able sixty days after proof of loss (R. 236, 1248, 1621, 1804-6). If during the concluding sixty days of a given period a relatively large number of losses occur and are adjusted (so that although not paid, liability therefor is fixed) then the incurred losses would exceed the paid losses. In the particular test period here in question the Missouri incurred losses were greater in three of the five years, and less in the other two years, than the paid losses (Plaintiffs' exhibits 1359 and 1361 at R 1925 and 1934).

Numerous expert witnesses of many years experience testified that underwriting profit can only be ascertained by deducting from earned premiums the incurred losses and expenses (R. 831-3, 837, 959, 209, 181-2, 216-17, 227-8, 666-7, 698-9, 711, 420-1, 1173-4, 1206, 1310, 1486, 1505-6, 1536-7, 1604, 1667, 1687, 1782-3, 1787); and that the calculation of profit upon the basis of premiums received less losses and expenses paid is fundamentally wrong because it ignores the necessity of reserving a part of the premiums received to take care of the obligations of unexpired policies. (R. 209, 195-6, 708-9, 764, 766, 806, 182, 959-60, 1506, 1660); and that an insurance company on the received and paid basis might appear prosperous yet when taking into account the required reserve might be actually insolvent (R. 837-8, 864-5, 2142, 2796, 2284-5).

It is now and has been for a great many years the universal practice in the insurance business to calculate underwriting profit upon the earned and incurred basis, and not upon the received and paid basis (R. 3045, 959, 1538, 228, 233, 863, 1310, 1359, 1369-70, 1459, 1504, 1660). The earned and incurred method is used by all insurance companies for their own profit calculations, for purposes other than rate making as well as rate making, and is universal in the business (R. 3045, 863, 228, 754, 1359, 1426, 1428, 1504, 1516, 1532-3, 1538).

The National Convention of Insurance Commissioners of the several states have ruled that "underwriting profit (or loss) is arrived at by deducting from earned premiums all incurred losses and incurred expenses" (R. 831, 1371).

Congress in imposing taxes upon income of insurance companies prescribes that the term "underwriting income means the premiums earned on insurance contracts during the taxable year, less losses incurred and expenses incurred" (Sec. 246 of Revenue Acts of November 23, 1921, June 2, 1924 and February 26, 1926, printed in appendix hereto, R. 864, 876).

By statutes of Missouri (printed in the appendix hereto) the insurance companies are compelled to set aside the unearned portion of the premium in a reserve (Sec. 6222, R. S. Mo. 1919), and are prohibited from paying dividends except from "surplus profits" (Sec. 6333, R. S. Mo. 1919), which under said Section 6222, R. S. Mo. 1919 are arrived at by offsetting against assets all current liabilities, including unearned premiums (R. 1277). So although the payment by an insurance company of dividends out of unearned premiums would be a violation of the Missouri statutes, the opinion below nevertheless treats $8,688,365 of unearned premiums as "earnings."

The insurance companies are required to make annual statements to the Superintendent upon blanks provided by him, which blanks are in form prepared by the National Convention of Insurance Commissioners and are familiarly designated as the convention form of annual statement blank. On one page of the blank the companies are required to show their nationwide underwriting profit or loss. The basis there prescribed is premiums earned less losses and expense incurred (R. 187-190, 863, 228, 232, 709, 1371, 1536-7, 2141-2, 2204, 2295, 2806-7).

Petitioners contended below that the calculation of underwriting profit or loss upon the received and paid basis, instead of upon the earned and incurred basis, is unreasonable, arbitrary and fundamentally erroneous, and that the reduction of rates based thereon is confiscatory and a denial of due process (R. 33, 35, 2995-8, 3048-9, 2884-6); and this contention was disallowed (R. 3017-23).

(b) Not only does the opinion below include as income all premiums received, thereby treating unearned premiums as the unqualified property of petitioners, but in addition to this includes as underwriting income for rate-making purposes the sum of $2,301,132 stated by the opinion to be interest on unearned premiums (R. 3023-28, 3034-5); and thereby interest derived from the investment of petitioners' assets (declared to be their unqualified property) is applied to a reduction of rates for underwriting.

Petitioners have two separate and distinct activities or departments of their business, to-wit, underwriting and investments, each being productive of a profit or a loss (R. 1530, 745, 770, 823, 842, 959, 989-90, 1320-2, 2848). The opinion takes income from one department (investment) and applies it to a reduction of rates for service in another department (underwriting). The effect of this holding is to require petitioners to do their underwriting business at rates of premium which will result in loss, or yield less than a reasonable profit, on the theory that by the application of interest earnings from another department such loss or deficiency in profit may in whole or in part be overcome. Petitioners attacked this theory as confiscatory (R. 33, 35, 590-1, 595-6, 599-600, 372-7, 400-2, 463-4, 468, 469, 491-2, 563, 608-9, 611-18, 620-662, 2043, 2047-9, 2052, 2216-17, 2263-4, 2880, 2884-6, 2987-92, 3054-5), and the contention was disallowed (R. 3023-8, 3075).

In the dissenting opinion petitioners' contention is approved, and the view is expressed that if the received and paid basis be adopted, then interest earnings from unearned premiums cannot be included as income without invading petitioners' constitutional rights (R. 3044-6).

(c) In ascertaining the alleged profit for the test period, the opinion below deducts from petitioners' expenses $2,496,715 excess commissions, to-wit, commissions paid by petitioners to their St. Louis agents upon a scale higher than that in force elsewhere in Missouri. This deduction is based upon the alleged ground that the excess commissions were unreasonable expenses (R. 3032-5).

The excess commissions were a necessary part of petitioners' expenses, incurred and paid in good faith. St. Louis agents, by reason of the higher cost of operating agencies in that city as compared with the cost in the rest of the state, and because of additional service rendered by them, have for many years exacted from petitioners a higher scale of commissions than are paid elsewhere in the state. These increased commissions are expenses which, according to the best judgment and discretion of petitioners' respective officers, are reasonable, and which petitioners are compelled to pay if they do business in St. Louis. This expense is forced upon petitioners by competition (R. 772, 1741, 1770-2, 1778, 785, 1610-11, 725, 1557, 1481-3, 1767). While petitioners by the laws of Missouri must write business at uniform rates, there is nevertheless keen competition between them in the acquisition of business and of desirable brokerage and agency connections.

Petitioners contended below that the Superintendent cannot constitutionally be permitted to substitute his judgment for the discretion of the petitioners respecting the necessity and reasonableness of this expense; and that to hold otherwise is to invade the inherent right of petitioners to conduct their own business in their own way, and to deny them due process (R. 34, 37, 2216-7, 2264, 2986,

2993-5, 3055-7). The contention was disallowed (R. 3032-3, 3075).

(d) In determining whether the ten per cent reduction in rates was reasonable, the opinion below (R. 3034-5) deducted from petitioners' expenses during the test period the sum of $628,123 Federal war tax on Missouri premiums (imposed by Secs. 504-5 of Act of October 3, 1917; Sec. 503(b) of Act of February 24, 1918; war tax repealed by Sec. 1400 of Act of November 23, 1921). The war tax was a necessary operating expense. Petitioners were compelled to pay it, and did pay it, as a necessary incident to their doing business in Missouri (R. 405, 411, 214, 529, 1952). The rejection of this item was attacked as confiscatory (R. 34, 37, 2986, 2993-5, 3056), and the point was disallowed (R. 3034-5, 3075).

(e) The opinion below held that 8 per cent of $83,502,181 premiums received, or $6,680,169, would be a reasonable profit to petitioners for the test period (R. 3035). In making this allowance no provision whatever was made for proper elements of income and outgo, or for the unearned premium reserve which petitioners are compelled by law to set aside (Sec. 6222, R. S. Mo. 1919). The average or mean unearned premium reserve for the test period was $12,717,016 (see Plaintiff's Exhibit 1359 at R. 1925), or substantially twice the amount of the reasonable "profit" fixed by the opinion below. Sixty per cent of the unearned premium reserve is drawn from premiums received, and the remaining forty per cent from free surplus (R. 838-9, 964, 1541-2).

The opinion below states that "a reasonable profit, it seems to be agreed, is 5 per cent on the underwriting business done, with 3 per cent additional for conflagration hazard" (R. 3011). This is not an accurate statement of the record. Petitioners' evidence as to the amount of a reasonable profit is that 8 per cent of premiums earned ($74,813,816), or $5,985,105, would be a reasonable profit (R. 983, 719, 771, 832, 851, 1176, 1230,

1487, 1547, 1693-4). This measure of profit, however, was based upon a calculation of underwriting profit or loss by the earned and incurred method (R. 851, 1231, 1693-4), under which method the unearned premium is set up as a liability *before calculation of profit.*

The opinion below fixed 8 per cent of premiums received, or $6,680,169, as the amount of a reasonable profit on the business of the test period, but entirely disregarded the fact that an amount in excess of that sum, set aside out of premiums received to make up the unearned premium reserve, more than consumed the entire "profit" allowed. Petitioners contended that in this respect the standard of profit fixed by the opinion is founded upon a fundamentally erroneous basis, and is confiscatory (R. 3048, 3060), and the contention was disallowed (R. 3075).

(f) Petitioners further contended below that the rating act (Sec. 6283, R. S. Mo. 1919), as now construed, is unconstitutional upon each of the grounds assigned in the attack upon the rate reduction order. Petitioners do not attack the constitutionality of the statute as written, but attack its constitutionality as it is applied in the instant case (R. 35, 37, 621-2, 2216-7, 2263-4).

All of the foregoing Federal questions were specially asserted by petitioners at the earliest possible stage, and were kept alive throughout the proceedings below. They were asserted in the original petition, objections to evidence, briefs and motion for rehearing (R. 31-2, 33-5, 37, 328, 372-7, 397-8, 400-2, 439-40, 463-4, 467-9, 472-3, 557, 563, 575-6, 590-1, 595-6, 599-600, 608-9, 611-18, 620-662, 491-2, 2043, 2047-9, 2052, 2216-7, 2263-4, 2880, 2986-99, 2047-9, 3054-7). The effect of the majority opinion is to deny each of them.

It is a noteworthy fact that upon the figures adopted by the opinion below, the rate reduction order is sustained by the narrow margin of $607,040. That is to say, the opinion finds that, after applying the ten per cent reduc-

tion, the petitioners on the volume of business in the test period would earn a profit of $7,287,209, and that a reasonable profit on that volume of business would be $6,680,169 (R. 3034-5). Therefore the profit which the opinion says petitioners would earn with the reduction applied is only $607,040 in excess of the amount which the opinion finds would have been a reasonable profit. Each of the items complained of by petitioners involves more than $607,040. The net result is that if any one of petitioners' contentions is sustained, the rate reduction order is demonstrably confiscatory.

SPECIFICATION OF ERRORS.

1. The Missouri Supreme Court erred in adopting the received and paid method of calculating underwriting profit, instead of the earned and incurred method, and in thus including as income $8,688,365 of unearned premiums and rejecting as outgo $1,662,969 of incurred losses and expenses; and thereby adopted an unreasonable, fundamentally erroneous and confiscatory method of calculation, which deprives petitioners of their property without due process of law.

2. The court erred in applying $2,301,132 interest earnings from invested assets to a reduction of rates for underwriting, and thereby adopted an unreasonable and confiscatory method of arriving at petitioners' profit or loss from underwriting, by which petitioners are deprived of their property without due process of law.

3. The court erred in deducting from petitioners' expenses $2,496,715 commissions paid to their St. Louis agents, and thereby adopted a method of arriving at petitioners' profit or loss which is unreasonable and confiscatory, depriving petitioners of their property without due process of law.

4. The court erred in rejecting from petitioners' expenses $628,123 war tax on premiums, and thereby adopted a method of arriving at petitioners' profit or loss which is unreasonable and confiscatory, depriving petitioners of their property without due process of law.

5. The court erred in fixing 8 per cent of premiums received, or $6,680,169 as a reasonable profit upon the business of the test period, and in failing to make allowance for proper elements of income and outgo, and for the unearned premium reserve, and in ignoring the fact that the amount of premiums received which petitioners were required to set aside in the unearned premium reserve

more than consumed the entire "profit" allowed; and thereby the court adopted an unreasonable, fundamentally erroneous and confiscatory standard of profit, by which petitioners are deprived of their property without due process of law.

6. The court erred in holding the rating statute (Section 6283, R. S. Mo. 1919) constitutional, whereas said statute as construed and applied by the court is in violation of Section 1 of the Fourteenth Amendment, in that it deprives petitioners of their property without due process of law.

SUMMARY OF ARGUMENT.

I.

The adoption of the received and paid method instead of the earned and incurred method of calculating petitioners' underwriting profit is unreasonable, fundamentally erroneous and confiscatory.

By the received and paid method $8,688,365 of premiums which were not earned during the test period are included as accrued income, and $1,662,959 of losses and expenses which were actually incurred during the test period are rejected as outgo. This is unreasonable and fundamentally erroneous.

The received and paid method erroneously ignores the fact that the unearned premiums so included as accrued income were in fact set aside in the unearned premium reserve as a *liability*, to take care of future losses, expenses and return premiums upon outstanding policy contracts.

The received and paid method erroneously ignores the fact that the losses and expenses incurred during the test period were definitely fixed liabilities of the test period, and were therefore as much a part of outgo as the losses and expenses paid.

The earned and incurred method of calculating underwriting profit has been in universal use in the insurance world from time immemorial; and has been expressly approved by the National Convention of Insurance Commissioners, and also by Congress in the levy of income tax upon insurance companies (Sec. 246 of the Revenue Acts of 1921, 1924 and 1926); and is prescribed by the annual statement blanks of the forty-eight states as the basis for reporting underwriting experience.

By the laws of Missouri insurance companies are compelled to set aside all unearned premiums in a reserve, which is a liability (Sec. 6222, R. S. Mo. 1919); and are prohibited from paying dividends out of unearned premiums (Sec. 6333, R. S. Mo. 1919). It is unreasonable and fundamentally erroneous to treat unearned premiums as accrued income when confessedly they are not free assets and cannot be distributed as dividends.

By the language of the rating statute (Sec. 6283, R. S. Mo. 1919) the Superintendent may only reduce rates if petitioners' "earnings" are excessive. It is a plain contradiction in terms to say that *unearned* premiums are *earnings*.

The earned and incurred method has been judicially approved in the only two decisions which have hitherto decided the point.

> *Sun Insurance Office* v. *Clark*, App. Cases, Law Reports 1912, p. 443.
> *Bullion* v. *Aetna Ins. Co.*, 151 Ark. 519, 237 S. W. 717.

The Superintendent cannot substitute for a reasonable rate a lower rate, on the alleged ground that the petitioners by previous dealings with the Insurance Department have acquiesced in the received and paid method, and have thereby become estopped from charging a reasonable rate.

> *Southern Pacific Co.* v. *Interstate Commerce Commission*, 219 U. S. 433.

The received and paid method being unreasonable, fundamentally erroneous and confiscatory, is a denial of due process.

> *Northern Pacific Ry.* v. *Department of Public Works*, 268 U. S. 39, l. c. 44-45.

Ohio Utilities Company v. *Public Utilities Commission*, 267 U. S. 359.
Interstate Commerce Commission v. *Union Pacific Railroad*, 222 U. S., l. c. 547.
Bluefield Water Works and Improvement Co. v. *Public Service Commission*, 262 U. S. 679.
Vandalia Railroad Co. v. *Schnull*, 255 U. S. 113.
Union Tank Line Co. v. *Wright*, 249 U. S. 275.
Brooks-Scanlon v. *Railroad Commission*, 251 U. S. 396.
Northern Pacific Ry. Co. v. *North Dakota*, 236 U. S. 585.

II.

The application of $2,301,132 interest earnings from investments to a reduction of rates for underwriting is unreasonable and confiscatory.

The majority opinion treats all premiums received, both earned and unearned, as income—thereby treating unearned premiums as the unqualified property of petitioners. Notwithstanding this, the majority opinion also includes as underwriting income $2,301,132 interest earnings derived from the investment of unearned premiums. These two propositions are fundamentally inconsistent.

Dissenting opinion herein (R. 3044-6).

Insurance companies have two separate activities, underwriting and investment, each being productive of a profit or a loss. The majority opinion takes income from one department (investment) and applies it to a reduction of rates in a distinct department (underwriting). The effect of this is to compel petitioners to do their underwriting business at a loss if by the application of income from invested assets such loss may be overcome. Inadequate rates for underwriting, standing alone, cannot be justified upon the ground that petitioners are earning income from their invested assets (over which the state concededly has no control in the making of rates) suffi-

cient to overcome the loss in underwriting. Petitioners are entitled to rates sufficient to make their underwriting activity, standing alone, reasonably profitable. Anything less than this is a denial of due process.

Smyth v. *Ames*, 169 U. S., l. c. 540, 541.
Minnesota Rate Case, 230 U. S. 352, l. c. 440.
Northern Pacific Railway Co. v. *North Dakota*, 236 U. S., l. c. 599.
Brooks-Scanlon v. *Railroad Commission*, 251 U. S. 396.
Vandalia Railroad Co. v. *Schnull*, 255 U. S. 113.
Norfolk and Western Railway Co. v. *Conley*, 236 U. S. 605.
Interstate Commerce Commission v. *Union Pacific*, 222 U. S. 541, 549.
Board of Public Utility Commissioners v. *New York Telephone Co.*, 46 Sup. Ct. Rep. 363.

III.

The deduction from petitioners' expenses of $2,496,715 excess commissions paid to their St. Louis agents is unreasonable and confiscatory.

These commissions were a reasonable and necessary expense, forced upon petitioners by competition and by the higher cost of operating agencies in St. Louis, and by the additional service furnished by St. Louis agents.

This expense was incurred in good faith and without any abuse of discretion. The incurring of it was a matter requiring business judgment. The Superintendent is not empowered to substitute his judgment for the honest discretion of petitioners; and he cannot, consistently with the due process clause, order a rate reduction based upon an arbitrary exclusion of this expense.

Southwestern Bell Telephone Co. v. *Public Service Commission*, 262 U. S., l. c. 288-289.
Houston v. *Telephone Company*, 259 U. S., l. c. 323.

Ohio Utilities Co. v. *Public Utilities Commission,* 267 U. S., l. c. 363.
Banton v. *Belt Line Ry.,* 268 U. S., l. c. 421.
Dayton-Goose Creek Ry. v. *United States,* 263 U. S., l. c. 483.
Wolff Packing Co. v. *Court of Industrial Relations,* 262 U. S. 522.

Petitioners are free to manage their business upon the same principles of competition as other occupations and pursuits.

Interstate Commerce Commission v. *Chicago Great Western Railway Company,* 209 U. S., l. c. 118-119.

IV.

The rejection of $628,123 war tax as an item of expense is unreasonable and confiscatory.

This tax was actually paid as a necessary incident to doing business in Missouri (Sec. 504-5, Revenue Act of 1917; Sec. 503-b, Revenue Act of 1918), and was a proper item to be included as outgo. Its rejection was unreasonable and confiscatory, and in direct conflict with the decisions of this court.

Galveston Electric Co. v. *Galveston,* 258 U. S., l. c. 399.
Georgia Railway & Power Co. v. *Railroad Commission,* 262 U. S. 633.

The fact that the statute imposing the war tax was repealed during the last year of the test period is immaterial; the tax was an actual expense of the test period and there is no warrant for the conjecture by the court

that during subsequent years there would not be taxes as great or greater than the war tax.

Pacific Gas & Electric Co. v. *San Francisco* 265 U. S. 403.

Chicago & Northwestern Railroad Company v. *Dey*, 35 Fed. 866.

V.

The fixing of 8% of premiums received, or $6,680,169, as a reasonable profit upon the business of the test period was unreasonable and confiscatory, because no allowance was made for proper elements of income and outgo or for the unearned premium reserve.

The average unearned premium reserve for the test period was $12,717,016, 60 per cent of which (or $7,630,209) was drawn from premiums received. Therefore, the sum of $6,680,169, fixed by the opinion as a reasonable "profit," was more than consumed by the unearned premium reserve—a fact entirely disregarded by the court below. The method used in arriving at a measure of profit is therefore unreasonable, fundamentally erroneous and confiscatory, and a denial of due process.

Northern Pacific Ry. v. *Department of Public Works*, 268 U. S. 39, l. c. 44-45.

Ohio Utilities Company v. *Public Utilities Commission*, 267 U. S. 359.

Interstate Commerce Commission v. *Union Pacific Railroad*, 222 U. S., l. c. 547.

Bluefield Water Works and Improvement Co. v. *Public Service Commission*, 262 U. S. 679.

Vandalia Railroad Co. v. *Schnull*, 255 U. S. 113.

Union Tank Line Co. v. *Wright*, 249 U. S. 275.

Brooks-Scanlon v. *Railroad Commission*, 251 U. S. 396.

Northern Pacific Ry. Co. v. *North Dakota*, 236 U. S. 585.

VI.

The rating statute as construed and applied in the instant case is unconstitutional and in violation of the due process clause of the Fourteenth Amendment.

The statute as written was not attacked by petitioners, but the statute as construed and applied in the instant case was attacked, as depriving petitioners of their property without due process of law, thereby presenting a federal question.

Myles Salt Co. v. *Iberia Drainage District*, 239 U. S., l. c. 484.
Reagan v. *Farmers Loan & Trust Co.*, 154 U. S., l. c. 390-391.
Greene v. *Louisville & Interurban Railroad Co.*, 244 U. S., l. c. 507.
Raymond v. *Chicago Traction Co.*, 207 U. S., l. c. 20.
Castillo v. *McConnico*, 168 U. S. 674.
Old Colony Trust Co. v. *Omaha*, 230 U. S. 100.

The statute as construed and applied is unconstitutional upon each of the grounds asserted by petitioners in their attack upon the reduction order.

The Rating Act cannot be upheld as a condition upon which foreign corporations may do business in the state.

Carroll v. *Greenwich Insurance Co.*, 199 U. S., l. c. 409.
Cargill Co. v. *Minnesota*, 180 U. S. 452.

The state is without power to impose an unconstitutional requirement.

Frost v. *Railroad Commission*, 46 Sup. Ct. Rep. 605.
Terral v. *Burke Construction Co.*, 257 U. S. 529.
Fidelity & Deposit Co. v. *Tafoya*, 46 Sup. Ct. Rep. 331.
Western Union Telegraph Co. v. *Kansas*, 216 U. S. 34.

VII.

If any single point of attack upon the rate reduction order is sustained, the order must fall.

The opinion sustains the order by the narrow margin of $607,040. That is, the opinion finds that with the reduction applied, petitioners would during the five-year period have derived a profit only $607,040 in excess of a reasonable profit. Each point of attack upon the order involves more than $607,040. Therefore, if any one or more of petitioners' contentions are sustained, the rate reduction is demonstrably confiscatory.

VIII.

In the exercise of a sound judicial discretion, certiorari should issue.

The questions presented are federal questions of tremendous importance in Missouri and numerous other states having statutes authorizing the regulation of insurance rates. These questions sooner or later must inevitably be decided here. This case squarely presents them.

If the rate reduction should be sustained, the petitioners will be subjected to ruinous loss, in that they will be compelled (a) to refund to Missouri policyholders approximately $7,000,000, representing the difference between the old rate level and the reduced rate level, and (b) either to do business in Missouri at confiscatory rates or leave the state and thereby lose their agency plants, which constitute property of substantial value.

Denver v. *Denver Water Co.*, 246 U. S. 178.

ARGUMENT.

The rate reduction order and the opinion below in adopting the received and paid method instead of the earned and incurred method, and in thus including as accrued income $8,688,365 of unearned premiums, and rejecting as outgo $1,662,959 of incurred losses and expenses, adopt a method of calculating profit which is unreasonable, fundamentally erroneous and confiscatory.

The rate reduction order and the opinion below base the ascertainment of alleged profit upon premiums *received* less losses and expenses *paid*, instead of upon premiums *earned* less losses and expenses *incurred*, during the test period (R. 3017-23).

1. The theory of the majority opinion is that in arriving at the profit of a test period, all premiums received during the period, although the terms of some policies extend beyond such term, shall be treated as accrued income. This theory obviously proceeds upon a fundamentally erroneous principle, because it ignores the fact that that portion of the premiums received upon unexpired policies which, at the end of the period still remain unearned, is subject to two definite contingencies: (a) repayment to policyholders upon cancellation as provided in the policies, and (b) payment of losses and expenses under such policies. As long as any part of the premium received remains unearned (the service paid for not having been rendered), such prepaid amount is subject to being absorbed in whole or in part by one or both of these contingencies, and cannot logically be considered as accrued income. Until it is earned, premium remains subject to such future contingencies, and by law is set up as a liability to meet them. Unearned premium is not a free fund, which the insurance company may distibute as

dividends or otherwise divert, but is fettered by the restrictions of the reserve statute.

To illustrate: Suppose an insurance company during a given year receives $100,000 in premiums and pays $90,000 in losses and expenses, leaving a balance of $10,000, sometimes referred to in the record as a "trade balance" (R. 3019). The holding of the majority opinion is that this $10,000 trade balance is clear profit—completely disregarding the fact that such balance would be inadequate to provide an unearned premium reserve at the end of the year sufficient to carry out unexpired policy contracts. It is fallacious to denominate as profit the $10,000 which remains subject to future payment of losses, expenses and return premiums upon existing contracts.

The unearned premium reserve is a *liability*, and no amount of sophistry can make it anything else. The statute expressly says it is a liability (Sec. 6222, R. S. Mo. 1919); the Missouri annual statement blank requires it to be set up as such (R. 951, 1277); and every witness who testified on the subject says it is a liability (R. 847, 889-90, 960, 971-2, 698, 705, 767, 510, 801, 810, 1064-5, 1159, 1161, 1192, 1498-9, 1533-4, 1955, 2775). How then, in reason, may it be said that an unearned premium, set apart in the reserve as a *liability*, constitutes accrued income? No insurance man possessing the slightest regard for the solvency of his company and the safety of his policyholders, would so regard it. A company which would do business upon such a basis, and would distribute in dividends its unearned premiums, without setting aside an unearned premium reserve to take care of future payments upon outstanding contracts, would immediately forfeit its license to do business (R. 2119-20, 2284-5, 2795-6), and would quickly find its way to inglorious bankruptcy. Yet this is precisely the principle which the majority opinion adopts in the ascertainment of profit or loss for rate making purposes. It is within the bounds of

conservative statement to say that if the majority opinion herein should become the settled law of the land, it would entirely overthrow the fundamental principles upon which the business of insurance has been conducted since time immemorial.

2. The same logic which requires the use of earned premiums instead of paid premiums likewise requires the use of *incurred* losses and expenses instead of *paid* losses and expenses. To reach the profit of a period, the liabilities incurred during that period must of necessity be used. It is obviously improper to include liabilities of a preceding period or to exclude liabilities of the period under consideration. What the companies have incurred and owe at the end of the period is as much a proper charge as the amounts which they have incurred and paid out. Upon this point the referee said (R. 2918): "Common honesty demands that one who has incurred an obligation should make provision for its payment. * * * One may not contract a debt and count it a profit. If a man erects a building at a cost of $50,000, and in doing so, pays $25,000 for labor and material, and then sells it for $50,000, leaving incurred but unpaid bills in the sum of $25,000, can he be said to have made a profit of $25,000, or any other sum? The question answers itself. He cannot. Incurred obligations, if just, must be paid, and there can be no profits until they are paid. It follows that the incurred basis is correct."

For illustration, assume the San Francisco conflagration had occurred in the latter part of December, 1906. The losses occasioned thereby would not have been actually paid within that year. Upon the received and paid basis the insurance companies at the close of the year might have shown a profit upon their California business when in fact they incurred a $350,000,000 loss (R. 981), which put many of them out of business (R. 917).

3. In the test period here in question the premiums received were $83,502,181, but of this amount only $74,

813,860 was earned, leaving a balance of $8,688,365 of premiums received but not earned during said period (R. 3007, 3034-5; see also Plaintiff's Exhibits 1359 and 1361, at R. 1925 and 1934). The method adopted in the opinion is to include as income of the test period both earned and unearned premiums, indiscriminately. It is conceded that $8,688,365 of premiums thus included were not earned at all, but at the end of the test period remained in the unearned premium reserve. In short, the opinion treats as "earnings" and as "aggregate profit" that which concededly was not earned and was not profit.

The losses and expenses paid were $80,161,057, but the losses and expenses incurred were $81,824,016 (R. 3007, 3034-5; see also Plaintiffs' Exhibits 1359 and 1361 at R. 1925 and 1934). So there was a balance of $1,662,959 of incurred but unpaid losses and expenses. Petitioners' liability for this balance of losses and expenses incurred was firmly fixed during the test period (R. 1036-38, 1386, 1507). The opinion nevertheless refuses to include this balance as outgo.

4. An overwhelming mass of evidence was introduced from witnesses who have devoted their lives to the insurance business, showing that underwriting profit can only be ascertained by deducting from *earned* premiums the *incurred* losses and expenses (R. 831-3, 837, 959, 209, 181-2, 216-7, 227-8, 666-7, 698-9, 711, 420-1, 1173-4, 1206, 1310, 1486, 1505-6, 1536-7, 1604, 1667, 1687, 1782-3, 1787); and that the calculation of profit upon the basis of premiums received less losses and expenses paid is fundamentally wrong, *because it ignores the reserve requirements* (R. 209, 195-6, 708-9, 764, 766, 806, 182, 959, 960, 1506, 1660). The Superintendent's expert witnesses quite frankly admitted that on the received and paid basis the whole premium is treated as earned, and the unearned premium liability is ignored as if non-existent (R. 2790, 2778); and that a company by using the received and paid method might appear prosperous, yet when taking account

of the required reserves be *actually insolvent and ineligible to do business in Missouri* (R. 2796, 2142, 2284-5, 2795-6, 837-8, 864-5). It is respectfully submitted that any method of calculation which lends itself to such a distorted misrepresentation of actual facts is not worthy of judicial approval.

As pointed out in the dissenting opinion, it has for many years been "the universal custom and practice of stock fire insurance companies to compute their underwriting profits on the basis of earned premiums" (R. 3045). The record supports this statement, it appearing that the earned and incurred method is used universally by all insurance companies for their own profit calculations, not alone for rate making but for all purposes, and that this has been true for many years (R. 959, 1538, 228, 233, 863, 1310, 1359, 1369-70, 1459, 1504, 1660, 754, 1426, 1428, 1516, 1532-3, 1538). In fact no company was ever heard of which adopted any other basis (R. 228, 233, 872).

The National Convention of Insurance Commissioners representing the several states have likewise approved the earned and incurred method (R. 831, 1371), as has Congress in the income tax laws (Sec. 246 of Revenue Acts of November 23, 1921, June 2, 1924 and February 26, 1926, printed in appendix, and see R. 864, 876); and Great Britain has done likewise (opinion of House of Lords in *Sun Insurance Office* v. *Clark*, Appeal Cases, Law Reports 1912, p. 443).

5. By sound underwriting practice (R. 767) as well as by the statutes of Missouri (printed in appendix hereto) insurance companies are compelled to set aside the unearned portion of the premium in a reserve (Sec. 6222, R. S. Mo. 1919), and are prohibited from paying dividends out of unearned premiums (Sec. 6333, R. S. Mo. 1919). The rule is the same independent of statute (Cook on Corporations, Sec. 546; 6 Fletcher Encyc. of Corpora-

tions 6104; *Scott* v. *Eagle Fire Company*, 7 Paige 198; *Hope Mutual Ins. Co.* v. *Perkins*, 4 Rob. [N. Y.] 182). So it appears that an insurance company would be violating the law if it should distribute its unearned premiums in dividends. Notwithstanding this, the opinion below treats $8,688,365 of unearned premiums as "earnings" or "profit." It is respectfully suggested that a "profit" which legally cannot be distributed in dividends is most unique, and of a *genus* not hitherto judicially defined.

6. In the convention form of annual statements to Missouri and the other forty-seven states, insurance companies are required to show their national underwriting profit or loss upon the earned and incurred basis (R. 187-190, 863, 228, 232, 709, 1371, 1536-7, 2141-2, 2204, 2295, 2806-7). The same form of blanks have been in use in all the states (R. 181, 709, 863, 2142, 2806-7, 2850-1) for many years (R. 2133, 2291-2). It passes the bounds of belief that the earned and incurred basis can be wrong, and yet that every state in the Union would employ it for the purpose of ascertaining underwriting profit.

The Superintendent seeks to avoid the effect of this by the suggestion that this report is a mere solvency test. We submit this is no answer at all. If the earned and incurred method is proper for ascertainment of solvency, as the Superintendent's witnesses expressly admit it is (R. 2142, 2874), it is necessarily the proper method to determine whether a profit has been made (*Bullion* v. *Aetna Ins. Co.*, 151 Ark. 519, 237 S. W. 1. c. 718). If in testing the solvency of the companies, the Insurance Department should determine by the earned and incurred method that the companies have *lost* money, the department ought not in reason to be permitted, by using a different method, to conclude that the companies *made* money, and upon that finding to *still further reduce rates*. To permit the state to do this might be to permit

it to find the companies insolvent on the earned and incurred basis, yet further to reduce rates by the use of the received and paid basis. This is so palpably unreasonable that it cannot stand the test of analysis. For if a company, or all the companies, should appear to be insolvent by the application of one method (the earned and incurred), the state under its insurance laws would be compelled to forbid them from writing business within its borders; yet at the same time by the use of the received and paid method the state might *still further reduce rates. Reductio ad absurdum.*

7. The language of the rating act itself (Sec. 6283, R. S. Mo. 1919) is significant. Before the Superintendent may reduce rates he must investigate the companies' *"earnings."* It is a plain contradiction in terms to say that $8,688,365 of *unearned* premiums are "earnings."

8. The earned and incurred method has met with the explicit approval of the House of Lords and of the Supreme Court of Arkansas in two learned opinions dealing with this subject-matter.

In the case of *Sun Insurance Office* v. *Clark*, Appeal Cases, Law Reports 1912, p. 443, the House of Lords had for consideration the profits of an insurance company proper to be considered under the Income Tax Act of Great Britain. The question presented was whether, in the determination of profit, it was allowable to make "a proper reserve for unexpired and unearned premiums, to throw the real premium income into each year to answer its actual losses." The earned premium basis was sustained by the court, several opinions being filed.

In the opinion of Viscount Haldane, he says:

> "As Bray, J., puts it, the case is analogous to one in which if goods are bought their value cannot be treated as profit without deducting the value of the liability to pay for them which the buyer has incurred."

Lord Alverstone, in a concurring opinion, says:

> "Premiums are not profits or gains. They are receipts which must be brought into account and out of which, after proper deductions for losses, profits will accrue."

Lord Atkinson, in a concurring opinion, says:

> "The receipts of a business are not in themselves profits and gains within the meaning of the Income Tax Act, but it is what remains of those receipts after there has been deducted from them the cost of earning them, which constitute the taxable profits and gains. Now, what is the service which a fire insurance company renders to each insurer in consideration for the premium it receives? *It is only by rendering this service in each case that it earns these receipts.* The service consists in indemnifying the insurer against loss by fire during the continuance of his policy. * * * *If the accounts of the company are to be rendered before the date of expiry, then some division of the premium must be made and the portion to be appropriated to the service already rendered ascertained, the balance being appropriated to that portion of the service which is to be performed thereafter.* I think the description 'unearned premium' which has been used to describe this latter portion is a very appropriate and accurate description." (Italics ours).

The decision in the case cited is followed in *Bullion* v. *Aetna Insurance Company*, 151 Ark. 519, 237 S. W. Rep. 717, where the court, among other things, said of unearned premiums:

> "It is not a profit, for the simple reason that it is not earned; it may never be earned. The company could not use it for paying dividends or for other purposes of its own."

The court, in speaking of the earned premium method in that case, says:

> "For any given period this method represents a closed business transaction and is a sound rule of computation. Any other would be mere speculation."

Both the Sun Insurance Office case and the Bullion case were cited in the court below, but are not referred to in the majority opinion.

9. But even if the question had never been decided and it were necessary to reason it out from first principles, the same result inevitably would be reached. The word "profit" means gain. If a mercantile business is done for a year on a cash basis, and goods are sold and delivered during the year for cash and all expenses are paid in cash, and if its inventory is the same at the beginning and end of the year, then obviously the way to ascertain the profit is to deduct the cost and expense from the income received. This is the received and paid method, and it is proper enough in the case of a mercantile business done on a cash basis. But the insurance business is not that kind of a business (R. 231-2). The insurance company collects its premium in advance, but in turn issues a contract to indemnify against loss, which may occur at any time during a period of months or years. The transaction is not closed until the termination of the policy, either by its expiration or cancellation or by payment of a total loss (R. 704, 706, 209-10, 230, 477-8). In other words, the company has not earned the whole premium and cannot earn it until liability on the policy has ceased. The same principle is applicable to any mercantile or other business in which obligations incurred in a given year are partially performed in that year, leaving a remainder to be performed in the follow-

ing year; in arriving at the profit for the given year the earned basis necessarily would have to be used.

10. In the majority opinion it is argued that the earned and incurred method is wrong, because "when the companies are prosperous and their business is increasing in volume, according to the earned method they show a loss, whereas when their underwriting is falling off they show a profit" (R. 3018). The assumption that increased premium income means prosperity does not follow, because with the increased premiums come increased losses and expenses; and if the latter consume the former, there is no prosperity. The foregoing statement by the court is founded upon the evidence of the Superintendent's witness, McGee, who hypothetically transposed the petitioners' premiums written in 1917 and 1921, and those written in 1918 and 1920, leaving 1919 figures the same, and assumed further a transposition of the unearned premium figures at the beginning and end of each year of the five-year period; and, based on these assumptions, testified that the companies on such descending scale of business would have realized a profit of $9,992,508 (R. 2227). The conclusion of the witness is utterly fallacious for these reasons:

(a) The unearned premiums at the end of any given year represent the unearned portion of the premiums written during that year plus what is still unearned from the premiums of previous years. To transpose the figures so that the unearned premiums at the end of a year are placed at the beginning of the year and those at the beginning of the year are placed at the end of the year creates an *impossible relationship*, because in this way the unearned premiums from the given year are placed at the beginning of the year, *or before the business was actually written*. For example, in the year 1919 (shown in McGee's Table A, R. 2227) the unearned premiums at the beginning of the year were actually $10,-

612,159, and at the end were $12,628,009. It will thus be seen that as an actual fact the unearned premiums were approximately $2,000,000 greater at the end of the year than at the beginning. In his Table B, illustrating the transposition, the unearned premium at the beginning is stated at $12,628,009, and at the end, instead of being an increased figure it is a *reduced* figure, of $10,612,159—*an obviously impossible and preposterous figure.*

(b) Mr. McGee assumed an unearned premium figure at the end of the five-year period of $8,373,804. In point of fact, upon the volume of business written in the five-year period as he assumed it, the unearned premium at the end of the five-year period would have been tremendously increased over that figure.

(c) He assumed the incurred losses and expenses of the five-year period to have been $82,198,078. In fact, upon the volume of business which he assumed, the losses and expended incurred would have been enormously increased over that sum. His assumption that there was increased business prior to 1917, overlapping into the five-year test period, necessarily would mean losses upon such overlapping policies.

The juggling transposition of figures by Mr. McGee proves nothing. The assumptions he makes being impossible, necessarily his conclusion is wrong. The fact is that if the business had been on a descending scale, as he assumes, the unearned premium figure at the end of each year and of the period, and the losses and expenses incurred during the period, would have been so vastly increased over the figures he states in his tabulation that substantially the same underwriting loss would have been produced as was in fact produced.

Whether business is on an ascending or descending scale, the fact remains that the earned and incurred method charges the companies with every dollar of premium which they earn during the test period; and this

is all that in reason should be charged. The received and paid method charges them with every dollar of premiums received, whether earned or not, and regardless of whether they ever will be earned. The method is wrong for that reason. It completely ignores the reserve requirements of the statute, and the conceded fact that 20% to 25% of all premiums received are ultimately returned to policyholders on cancellation (R. 972-3, 733, 1360-1, 1580). Apparently overlooking this fact, the opinion below erroneously says that the possibility of cancellation "is so remote as to be negligible" (R. 3021).

11. The majority opinion concedes that the received and paid method is not indicative of solvency, and does not properly represent net earnings for the purpose of distribution of assets upon dissolution, yet nevertheless holds that it does reflect the "clear earnings of the period embraced, if that period be considered apart from those which preceded it and those which follow" (R. 3019). It is respectfully submitted that the "earnings" of a period are certainly not "clear" if a substantial per cent thereof are tied up in a reserve, and a large portion will ultimately have to be surrendered to policyholders (R. 1660-1).

12. The majority opinion argues that certain insurance companies in previous dealings with the Missouri Insurance Department have heretofore acquiesced in and acted upon the received and paid method in their application for increase of rates (R. 3019). It is true the evidence shows that since the Rating Act was passed in 1915 the Missouri Superintendent of Insurance has chosen to interpret the same as authorizing the calculation of underwriting profit upon the received and paid basis (R. 2302, 2744, 2837-8); and that the insurance companies in two previous applications for increase of rates, one in 1915 (R. 2833-5) and one in 1918 (R. 2311) conformed to such view by submitting their underwriting experience

upon the received and paid basis. However, it is apparent from the record that the reason for this was because the Superintendent insisted upon this theory, and the insurance companies chose to deal with him upon his own basis; and because even upon such theory, which was more favorable to the state than the earned and incurred basis would have been, the companies were found entitled to the increases asked (R. 2835, 2330-3).

It is a sufficient answer, however, to say that the Superintendent, as a rate regulating official, cannot substitute for a reasonable rate a lower rate, on the ground that the insurance companies by their former conduct have become estopped from charging a reasonable rate. This principle is squarely decided in *Southern Pacific Co.* v. *Interstate Commerce Commission*, 219 U. S. 433.

In addition to this, the question as to the proper method of calculating underwriting profit is a question of law; and the position of the insurance companies upon this question in their previous dealings with the Insurance Department is at most nothing more than the expression of an opinion upon a question of law. Under such circumstances there is no estoppel (*Sturm* v. *Baker*, 150 U. S. l. c. 335-7; 21 C. J. 1147; 22 C. J. 296, 333, 343, 423, 425; *Race* v. *Kurk*, 163 App. Div. 924, 147 N. Y. Supp. 818; *Rasseau* v. *Brookhart* (Mich.) 139 N. W. 2; *Rawlins* v. *Neal*, 122 N. C. 173, 29 S. E. 93).

13. The departmental interpretation of the rating act is of no force, because the construction of the statute is not doubtful (*Wisconsin Central R. R. Co.* v. *United States*, 164 U. S. l. c. 205; *United States* v. *Graham*, 110 U. S. l. c. 221); and because the natural and obvious interest of the department was to adopt that interpretation which would make the best showing for its activities (*State ex rel.* v. *Hyde*, 292 Mo. l. c. 355; *Trustees* v. *Laird*, 8 App. Cases, 658, 673), and because the rating act was of too recent origin for its interpretation by the department to

be accorded any weight whatever in its judicial construction (Lewis' Sutherland on Statutory Construction, Vol. II, p. 895; Black on Interpretation of Laws, pp. 31, 217, 128, 221).

14. In the opinion below it is said that the stand now taken by the petitioners upon the earned and incurred method has the appearance of having been "contrived for the purposes of this case" (R. 3019-20). *Nothing could possibly be further from the fact.* The rate reduction order here in question was made October 9, 1922 and this suit was filed November 10th of the same year (R. 9). Two years before that most of these petitioners had filed suit in Arkansas to review a rate reduction order made in 1920, contending (successfully) that the earned and incurred method should be adopted (*Bullion* v. *Aetna Ins. Co.*, 151 Ark. 519, 237 S. W. 717). Not only so, but in December, 1921, a year before this suit was filed, the insurance commissioners representing all the forty-eight states, after a two years investigation of the question, had adopted the earned and incurred method as the proper method of calculating underwriting profit (R. 825-35); and for a great many years all the states, including Missouri, had used the method in annual statement blanks (R. 2141-2, 2133, 2291-2, 181, 709, 863, 2806-7, 2850-1). The same method had been adopted in the collection of income tax by Congress (Sec. 246 of Revenue Act of November 23, 1921) one year before, and by Great Britain (*Sun Insurance Office* v. *Clark, supra*) ten years before this suit was filed. And as pointed out above, the testimony of a host of witnesses in the record shows that the use of the earned and incurred method *is as old as the insurance business itself, and is universal, and that no company was ever heard of which calculated its profit on any other basis.* The record therefore does not support, but affirmatively disproves, the assertion in the opinion that the earned and incurred basis is a method "contrived for the purposes of this case."

15. The majority opinion argues that it is improper to exclude unearned premiums from consideration, yet to include the expense incurred in acquiring the business which produced such unearned premiums (R. 3020, 3022). The opinion states that the cost of procuring insurance is approximately 40 per cent of the premium paid, and that this 40 per cent is deducted as expense incurred whereas the unearned premiums are excluded from income, under the earned and incurred method (R. 3020). The opinion errs in stating that the cost of procuring insurance is approximately 40 per cent, the record showing the average *total* expense to be 42 per cent (R. 1645), and the average agent's commission to be 22 per cent to 25 per cent (R. 114, 313, 771-2, 999, 1319, 1556); and usually only the agent's commission is paid in the year in which the business is written (R. 1630). Passing that, we submit there is nothing improper in rejecting premium income *for which value has not yet been delivered*, or in taking into account expenditures in fact incurred, during a test period (R. 1006-7, 1013-14, 1022-3, 1498-9). Furthermore, the exclusion of unearned premiums from the income of a given year is offset by premiums received in previous years becoming earned in the given year (R. 1069, 1752, 2130).

But even if it were conceded that there is any injustice in including as a part of the incurred expenses of the test period the cost of acquiring premiums unearned in said period, certainly there is no warrant in reason for excluding in this case a greater proportion of the total expenses incurred ($33,230,352) than the ratio which premiums unearned in the period ($8,688,365) bear to premiums received in the period ($83,502,181). Applying this theory to the experience of the test period would lead to this result: On the earned and incurred basis the petitioners' experience was as follows (R. 3007):

Earned Premiums		$74,813,816
Incurred Losses	$48,593,664	
Incurred Expenses	33,230,352	
Incurred losses and expenses combined		81,824,016
Underwriting loss (9% of earned premiums)		$ 7,010,200

Reducing the expenses incurred ($33,230,352) to the extent indicated, would reduce the underwriting loss about $3,325,000, and would still leave an underwriting loss of substantially $3,685,000. The rate order would of course have greatly increased such loss.

16. The majority opinion says that if the received and paid method is faulty the insurance companies cannot complain "because their accounts afford no other way" (R. 3022). The majority opinion is in error in this statement, the evidence being to the contrary (R. 704-5). And as above pointed out, the annual statements made to the forty-eight states require a report of underwriting profit on the earned and incurred basis; and necessarily the accounts of the companies are kept in such a way that this report can be made.

We will here anticipate some contentions which the Superintendent may present here, he having presented them below:

17. The Superintendent argued below that upon the earned and incurred basis "there never will be an apparent profit." A conclusive refutation of this contention is apparent from the figures in the record showing that a profit was derived in Missouri in 1917 and 1918 by thirty of the companies, in 1919 by seventy-three, in 1920 by thirty-seven and in 1921 by thirty-one companies; and in 1919 the aggregate experience of all the companies showed a $1,153,263 profit—upon the earned and incurred basis (see Plaintiff's Exhibits 1354 to 1359 at R. 1924).

18. The Superintendent argued below that while the Insurance Department receives from the companies a report of their nationwide experience upon the earned and incurred basis, it does not receive any report of their *Missouri* experience on that basis, and so cannot calculate underwriting profit on that basis. In answer to this we point out that Sec. 6281, R. S. Mo. 1919 (printed in the appendix hereto) requires the insurance companies to report to the Superintendent such information as he may require. So the Superintendent has *carte blanche* authority to require a report of Missouri experience upon the earned and incurred basis, if he desires it.

19. The Superintendent argued below that the method of computing the amounts of earned premiums, incurred losses and expenses is "purely arbitrary and just a pure guess." The evidence shows that the method employed is correct, as the opinion expressly finds (R. 3017-18, see also R. 1947, 178-80, 227, 232, 497, 699-700, 708, 1206; it is the method prescribed by the Missouri annual statement blank (R. 187-190), and by Congress in the income tax laws (printed in appendix), and the Superintendent's actuary expressly admitted its correctness (R. 2130-1). Furthermore, where absolute accuracy of calculation in rate cases is impossible, but where methods are available which produce results substantially or even approximately correct, this court has sustained them (*Union Tank Line Co.* v. *Wright*, 249 U. S. 275 and cases there cited).

20. The Superintendent offered as a witness the draftsman of the rating act (R. 2299) in the effort to show that when the act was drawn it was agreed between the insurance companies and the Insurance Department that it should be administered on the received and paid basis. In the first place the testimony of the witness shows that when the act was drafted there was no discussion one way or the other as to the proper basis of calculating underwriting profit (R. 2305-6). In the second place, the

intent of the draftsman of an act is of not the slightest weight in its judicial interpretation; the act must speak for itself (*Belleville Railroad Co.* v. *Gregory*, 15 Ill. 20; *Richmond* v. *Henrico County*, (Va.) 2 S. E. 26; *Tennant* v. *Kuhlemeier*, (Ia.) 120 N. W. 689; *Keyport Steamboat Co.* v. *Farmers Transportation Co.*, 18 N. J. Eq. l. c. 24; *Palmer Co.* v. *Flournoy*, (Va.) 14 S. E. 976; 26 Am. and Eng. Encyc. of Law, 638-639).

21. The Superintendent argued below that there is a "hidden profit" in the unearned premium reserve, and offered two witnesses to support this theory (R. 2202-3, 2758), one of whom later confessed his unwillingness to subscribe to it (R. 2762). The overwhelming evidence on the point is to the contrary (R. 313, 810, 971, 1250-1). Obviously the contention is absurd. How can any part of the unearned premium reserve be an accrued profit? It is a *liability*, a reserve set aside to guarantee fulfillment of outstanding contracts. As the unearned premium becomes earned premium it then (and not before) becomes accrued income.

22. We earnestly submit that in applying the received and paid method the opinion below adopts a method of calculation which is unreasonable, fundamentally erroneous and confiscatory; and that by the reduction in rates based thereon the petitioners are deprived of their property without due process of law in violation of the Fourteenth Amendment.

This court has definitely established the principle that the adoption by a rate-making body of a *method of calculation* which is unreasonable or fundamentally erroneous, is a denial of due process. In *Northern Pacific Ry.* v. *Department of Public Works*, 268 U. S. 39, l. c. 44-45, this court held that the state rate-making body's method of calculating the amount of returns from certain freight rates was fundamentally erroneous, and then said:

> "The mere admission by an administrative tribunal of matter which under the rules of evidence applicable

to judicial proceedings would be deemed incompetent, *United States* v. *Abilene & Southern Ry.*, 265 U. S. 274, 288, or mere error in reasoning upon evidence introduced, does not invalidate an order. But where rates found by a regulatory body to be compensatory are attacked as being confiscatory, *courts may enquire into the method by which its conclusion was reached.* An order based upon a finding made without evidence, the Chicago Junction Case, 264 U. S. 258, 263, or upon a finding made upon evidence which clearly does not support it, *Interstate Commerce Commission* v. *Union Parific R. R.*, 222 U. S. 541, 547, is an arbitrary act against which courts afford relief. *The error under discussion was of this character. It was a denial of due process.*" (Italics ours.)

Other decisions announcing substantially the same principle are as follows:

Ohio Utilities Company v. *Public Utilities Commission*, 267 U. S. 359.
Interstate Commerce Commission v. *Union Pacific Railroad*, 222 U. S. 1. c. 547.
Bluefield Water Works and Improvement Co. v. *Public Service Commission*, 262 U. S. 679.
Vandalia Railroad Co. v. *Schnull*, 255 U. S. 113.
Union Tank Line Co. v. *Wright*, 249 U. S. 275.
Brooks-Scanlon v. *Railroad Commission*, 251 U. S. 396.
Northern Pacific Ry. Co. v. *North Dakota*, 236 U. S. 585.

Under the principle announced in these cases it is clear that the method of calculating underwriting profit upon the received and paid basis, being fundamentally erroneous, is a denial of due process.

II.

The rate reduction order and the opinion below, in so far as they apply $2,301,132 interest earnings from investments to a reduction of rates for underwriting, are confiscatory.

1. The rate reduction order and the opinion treat all premiums received during the test period as income (R. 3034-5). The effect of this is to treat unearned premiums as income, that is, as the unqualified property of petitioners held for the benefit of their respective stockholders.

Notwithstanding this holding, the opinion also treats as underwriting income the sum of $2,301,132 interest derived from the investment of unearned premiums (R. 3023-8). Thereby the opinion takes interest derived from the *investment of petitioners' unqualified assets*, and applies the same to a reduction of rates for *underwriting*.

There is a fundamental inconsistency in holding (a) that unearned premiums are accrued income and therefore the unqualified property of the petitioners, and (b) that interest earnings from the investment of such unearned premiums can be applied to a reduction of rates for underwriting. Both propositions cannot possibly stand. If unearned premiums are the unqualified property of petitioners' stockholders so as to be classed as earnings for rate-making purposes, then the interest derived therefrom is pure *investment* income and not *underwriting* income; and the same cannot be applied toward a reduction of underwriting rates.

The majority opinion concedes that interest earnings from the investment of *capital and free surplus* constitutionally cannot be treated as income in fixing underwriting rates (R. 3012, 3023-4). Yet interest earnings from unearned premiums, which under the majority opinion become a part of the free surplus, are treated as income.

The dissenting opinion makes the inconsistency clear, in the following language (R. 3044-6):

> "The interest earnings on so much of the companies' assets as would be consumed in re-insuring all of their risks are no more attributable to the underwriting business than are the earnings on the remainder of their assets, and it is conceded by the opinion that the latter can not be taken in consideration in determining underwriting profits. *If, however, the view that interest on unearned premiums should be charged up to the insurer in determining his underwriting profits be the correct one, then the method of arriving at profits which takes unearned premiums into account is wrong.* Unearned premium, in whole or in part, cannot be reckoned as profit and at the same time the insurer be required to pay interest on it to the policy holder.
>
> There is but one theory consistent with the companies' constitutional rights upon which it can be held that they must account for interest on unearned premiums, namely: that the premiums, being paid in advance, must be regarded as in a sense the moneys of the policy holders until earned by the lapse of time. *For if the premiums as soon as they are received by an insurer become without qualification his absolute property, then certainly he can not be required to pay to the policy holders interest on them, or what is tantamount thereto, apply such interest to the reduction of the cost of their insurance. Such a requirement in that view would be plain confiscation.* And if the premiums belong to the policy holders until earned, then until that time arrives the insurer cannot strike a balance for the purpose of ascertaining his profits. *In other words, if the interest on unearned premiums enter into underwriting profits, such profits must be determined upon the earned premium basis.*
>
> For many years antedating the enactment of our rate statute it was the universal custom and practice of the stock fire insurance companies to compute their underwriting profits on the basis of earned

premiums. And that is the basis for determining the net income accruing from the business of underwriting as recognized in the income laws both of England and the United States. It is therefore entirely possible that our rate statute contemplates the same method of ascertaining underwriting earnings and profits, and, if so, that the statute be upheld with respect to its provision that the earnings on unearned premiums shall be taken into account. But be that as it may, it is clear to my mind that *the majority opinion is wrong in holding on the one hand that underwriting profits must be determined upon the basis of premiums received, which includes both the earned and unearned, and on the other hand that interest on unearned premiums must be taken into account.*" (Italics ours).

We submit the reasoning of the dissenting opinion on this point is unanswerable.

2. The insurance companies have two separate and distinct activities, underwriting and investments (R. 1530, 745, 770, 823, 842, 959, 989-90, 1320-2, 2848). Each is productive of a profit or a loss. The opinion in effect concedes that the evidence as to the separate character of these activities is undisputed (R. 3011-12). The National Convention of Insurance Commissioners has recognized it by ruling that "no part of the so-called banking profit or loss should be considered in arriving at underwriting profit or loss (R. 831). Congress has recognized it by levying income tax separately upon investment income and underwriting income (Sec. 246 of the Revenue Acts of 1921, 1924 and 1926),

The blanks upon which the petitioners make annual statements to the forty-eight states also recognize it by requiring separate statements of underwriting experience and investment experience (R. 1285-90, 2145). The line of cleavage is as distinct as between the freight and passenger traffic or the interstate and intrastate traffic

of a railroad, or the gas and electric business of a public service company.

The majority opinion takes income derived from one department (investment) and applies it to a reduction of rates for service in a distinct department (underwriting). This is plainly confiscatory. The effect of this holding is to require petitioners to do their underwriting business at rates which will result in loss, or yield less than a reasonable profit, on the theory that by the application of interest earnings from another department (investment) such loss or deficiency in profit may in whole or in part be overcome. This is a clear denial of due process.

The state cannot justify unreasonably low rates for underwriting, considered alone, upon the ground that the insurance companies are earning income from investments (over which the state has no control in the making of rates) sufficient to overcome the loss in underwriting. The insurance companies are entitled to rates sufficient to make their underwriting activity, standing alone, reasonably profitable.

This principle has frequently and uniformly been applied by this court in analogous cases, of which the following are typical:

Smyth v. *Ames*, 169 U. S., l. c. 540, 541.
Minnesota Rate Case, 230 U. S. 352, l. c. 440.
Northern Pacific Railway Co. v. *North Dakota*, 236 U. S., l. c. 585, 599.
Brooks-Scanlon v. *Railroad Commission*, 251 U. S. 396.
Vandalia Railroad Co. v. *Schnull*, 255 U. S. 113.
Norfolk and Western Railway Co. v. *Conley*, 236 U. S. 605.
Interstate Commerce Commission v. *Union Pacific*, 222 U. S., l. c. 547.
Board of Public Utility Commissioners v. *New York Telephone Co.*, 46 Sup. Ct. Rep. 363.

3. In the effort to sustain the inclusion of investment earnings, the majority opinion points out that Sec. 6281, R. S. Mo. 1919, requires petitioners to *report* to the Superintendent the "earnings on unearned premiums," and argues, "Why put it in the law if the Superintendent was not to consider it in making rates? * * * We regard that statute as a legislative determination that interest on unearned premiums is an underwriting profit, for the legislative body had no concern about any other kind of profit" (R. 3028). This does not help the matter, for these reasons: (a) If the statute is indicative of anything at all, it is that the Legislature meant to sanction the earned and incurred method of ascertaining underwriting profit. (b) It is certainly no justification for the adoption of the received and paid method (i. e., treating unearned premiums as the unqualified property of petitioners) and at the same time applying interest from the investment of unearned premiums to a reduction of underwriting rates. (c) As construed by the majority opinion, said section is unconstitutional because confiscatory, under the above decisions of this court.

4. The Superintendent contended below that petitioners had included the expense of their investment department in the amount of their underwriting expenses proven in evidence herein, and that therefore it would be unfair to exclude investment earnings from income. The majority opinion in effect holds against the Superintendent on this contention so far as interest earnings from capital and surplus are concerned (R. 3012). The evidence is undisputed that in petitioners' expense figures offered in evidence every item of investment expense capable of segregation is eliminated (R. 1915, 1961-2); and that that small amount of inseparable investment expense which could not be segregated (such as the president of a company spending a few minutes of his time in buying investment securities) would be more than covered by

one-half of one per cent of earned premiums (R. 1961-2, 1853-4), which is deducted from the underwriting expense in petitioners' tabulation in order to eliminate such otherwise inseparable items (Plaintiffs' Exhibits 1354-1359, inclusive, at R. 1924). The Missouri annual statement blank prescribes one-eighth of one per cent of mean invested assets as the measure of inseparable investment expense to be adopted by the petitioners in reporting to the state (R. 1289-90); and the evidence is that this is ample to cover such investment expense (R. 1091-6, 1106, 1538-40, 1587-9, 1594, 1200, 1853-4, 1915, 1961-2), and that it is more than covered by the deduction of one-half of one per cent of earned premiums (R. 1853-4). The net result is therefore that no part of petitioners' investment expenses are included in their underwriting expense figure of $33,230,352.

III.

The deduction from petitioners' expenses of the sum of $2,496,715 commissions paid to their St. Louis agents, is unreasonable and confiscatory.

In ascertaining the alleged profit for the test period, the opinion below deducts from expenses the sum of $2,496,715 excess commissions, to-wit, commissions paid to St. Louis agents upon a scale higher than that in force in the rest of the state. This deduction is based upon the alleged ground that the excess commissions were unreasonable expenses, and that petitioners should not have incurred them (R. 3032-5).

The excess commissions were a necessary expense (R. 772, 1741, 1770-1, 1772, 1778). The St. Louis agents, because of the higher cost of operating insurance agencies in that city as compared with the cost in the rest of the state (R. 785, 1610-11), and because of extra service furnished (R. 1481-3, 1610-11) and greater

brokerage commissions paid (R. 785-6, 1481-3, 1610-11, 1767), have for many years exacted from petitioners a higher scale of commissions than are paid elsewhere in the state (R. 1741, 1767). This increased scale is an expense which, according to the best judgment of petitioners' officers, is reasonable (R. 1770-2, 1778). Petitioners are necessarily compelled to pay this expense or cease doing business in St. Louis. It is forced upon them by competition (R. 725, 772, 1557).

It is all very well for the Superintendent by a stroke of the pen to attempt to change the method of doing business which has existed for over fifty years. But as a practical matter it cannot be changed as easily as that. Excess commissions in the larger cities present a condition, not a theory, and the companies are compelled to pay them if they expect to do business there. These commissions are a part of the cost of acquiring business, and are operating expense the same as the lower scale commissions paid in Sedalia or Springfield.

There is nothing in the record to indicate bad faith or abuse of discretion in the payment of this expense. The petitioners have exercised a proper discretion about the matter, which is one requiring business judgment. The Superintendent is not empowered to substitute his judgment for the honest discretion of the officers and directors of the petitioner companies. He cannot, consistently with the due process clause, order a rate reduction based upon his arbitrary refusal to include this expense in his tabulation.

This court has laid down the principle in *Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U. S., l. c. 288-289, as follows:

> "There is nothing to indicate bad faith. So far as appears, plaintiff in error's board of directors has exercised a proper discretion about this matter re-

quiring business judgment. It must never be forgotten that while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies and is not clothed with the general power of management incident to ownership. The applicable general rule is well expressed in *State Public Utilities Commission ex rel. Springfield* v. *Springfield Gas and Electric Company*, 291 Ill. 209, 234:

"'The commission is not the financial manager of the corporation and it is not empowered to substitute its judgment for that of the directors of the corporation; nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers.'"

To the same effect is *Houston* v. *Telephone Company*, 259 U. S. l. c. 323. In *Ohio Utilities Co.* v. *Public Utilities Commission*, 267 U. S. l. c. 363, the action of the state commission in arbitrarily deducting expenses incurred, was reversed because arbitrary and unreasonable. In *Banton* v. *Belt Line Ry.*, 268 U. S. l. c. 421, it is held that "subject to reasonable regulation in the public interest, the management and right to control the business policy of the company belong to its owners." As this court said in *Dayton-Goose Creek Ry.* v. *United States*, 263 U. S. l. c. 483:

> "The investment is made on the faith of a profit, the profit accrues from the balance left after deducting expenses from the product of the rates, *and the assumption is that the operation is economical and the expenditures are reasonably necessary.*" (Italics ours.)

See also *Wolff Packing Co.* v. *Court of Industrial Relations*, 262 U. S. 522, holding that a state may not dictate to an owner the amount of wages he must pay.

These excess commissions have been forced upon the insurance companies by legitimate competition. In the

case of *Interstate Commerce Commission* v. *Chicago Great Western Railway Company*, 209 U. S. l. c. 118-119, the railway company was charged with unlawful discrimination in carrying dressed beef at a cheaper rate than live stock. The railway asserted in defense that its action was induced by competition. This court upheld the defense, and held that the railroads were free "to manage their important interests upon the same principles which are regarded as sound and adopted in other trades and pursuits."

The exclusion from expenses of the sum of $2,496,715 commissions in St. Louis is arbitrary, unreasonable and confiscatory, and a denial of due process.

IV.

The rejection of $628,123 war tax on premiums as an item of expense is unreasonable and confiscatory.

In determining whether the ten per cent reduction in rates is reasonable, the opinion below deducts from the expenses of the test period the sum of $628,123 war tax on Missouri premiums (R. 3034-5).

The evidence is without dispute that this sum was actually paid (R. 405, 411, 214, 529, 1952). The war tax was imposed by the Federal Government on premiums (Sec. 504-5, Act of Oct. 3, 1917; Sec. 503(b), Act of Feb. 24, 1918), and the petitioners were compelled to pay it as a necessary incident to their doing business in Missouri.

1. This court has expressly held in *Galveston Electric Co.* v. *Galveston*, 258 W. S. l. c. 399, that in calculating whether a given rate will yield a proper return, it is necessary to deduct from gross revenue the expenses and charges; and that "all taxes which would be payable if a fair return were earned are appropriate deductions. *There is no difference in this respect between state and federal taxes or between income taxes and others.*" (Italics ours.)

This principle is again announced in *Georgia Railway & Power Co.* v. *Railroad Commission*, 262 U. S. l. c. 633. The majority opinion below is in direct conflict with the rule thus announced.

2. The only ground assigned in the opinion below for excluding this item is that the law imposing the war tax was no longer in operation at the time the reduction order was made (the war tax statute was repealed by Sec. 1400, Act of Nov. 23, 1921); and that therefore the war tax should not be "listed as an expense in fixing future rates" (R. 3034).

This court will note that the rating act (Sec. 6283 R. S. Mo. 1919) grants power to reduce rates only upon the actual results of the elapsed test period, and does not authorize any conjecture that during the years following there may not be taxes as great or greater than those in effect during the period. As this court said in *Pacific Gas & Electric Co.* v. *San Francisco*, 265 U. S. 403:

> "The problem was to ascertain the problem result of the specified rate if applied under well known *past* conditions, not to forecast the probable outcome of a proposed rate under *unknown future conditions.*" (Italics ours.)

A condition of the power to reduce rates is the judicial determination that there has been an unwarrantable profit in the past. Any other standard would be speculative and unconstitutional. As was said by Mr. Justice Brewer, in the case of *Chicago & Northwestern Railroad Company* v. *Dey*, 35 Fed. 866:

> *"But speculations as to the future are not guides for judicial action; courts determine rights upon existing facts.* Of course, there is always a possibility of the future; good crops may increase transportation business, poor crops reduce; high or low rates may likewise affect; *but the only fair judicial test is to apply the rates to the business that has been*

done in the past, and see whether upon that basis such rates will be remunerative, or compel the transaction of business at a loss."

In sustaining the rate reduction, based upon a rejection of the item of $628,123 war tax, the opinion is confiscatory and denies petitioners due process.

V.

The opinion below in fixing 8% of premiums received, or $6,680,169, as a reasonable profit upon the business of the test period, is confiscatory, because it fails to make allowance for proper elements of income and outgo, and for reserves; the fact being that petitioners were compelled during the test period to set aside reserves in the average amount of $12,717,006, 60% of which was drawn from premiums received.

The opinion below fixes 8% of $83,502,181 premiums received, or $6,680,169, as a reasonable profit to petitioners for the test period (R. 3035).

It is important to note that this allowance is made without the court taking into account the unearned premium reserve which petitioners are compelled by law to set aside (Sec. 6222 R. S. Mo. 1919). The conclusions reached in the majority opinion are summarized in a tabulation (R. 3034-5). From beginning to end the tabulation makes no reference to the unearned premium reserve, and from reading the tabulation one would never suspect that the companies are required to set up such a reserve (R. 3034-5).

The unearned premium reserve at the beginning of the test period was $8,372,804 and at the end of the period was $17,061,209 (see Plaintiffs' Exhibit 1359 at R. 1925). So the average unearned premium reserve for the period was $12,717,016. This is substantially twice the amount of the reasonable "profit" fixed by the opinion below.

Sixty per cent of the reserve is drawn from premiums received, and the remaining forty per cent from free surplus (R. 838-9, 964, 1541-2). Sixty per cent of the average reserve for the five year period is $7,630,209. The opinion below fixes 8% of the premiums received, or $6,680,169, as the amount of a reasonable profit, but blandly ignores the fact that an amount in excess of that sum was set aside out of premiums received as part of the reserve. *The proportion of the reserve drawn from premiums received would more than consume the entire "profit" allowed.*

It does not appear from what source the learned majority below supposed the unearned premium reserve would be drawn. *They wholly failed to make any allowance for this very important and substantial factor.*

The opinion states that it "seems to be agreed that a reasonable profit is 5 per cent on the underwriting business done, with 3 per cent additional for conflagration hazard" (R. 3011). This is not an accurate statement of the record. The uncontradicted evidence offered by petitioners as to the amount of a reasonable profit is that 8 per cent of $74,813,816 premium *earned*, or $5,985,105, would be a reasonable profit (R. 983, 719, 771, 832, 851, 1176, 1230, 1487, 1547, 1693-4). However, it is important to note that this measure of a reasonable profit was based upon a calculation of underwriting profit by the earned and incurred method (R. 851, 1231, 1693-4), under which method all proper items of outgo and the unearned premium reserve are set up *before calculation of profit.*

It is apparent that the majority opinion in fixing 8 per cent of premiums received as a reasonable profit, without making any provision whatever for the reserve, adopts a fundamentally erroneous and confiscatory method, and denies petitioners due process.

Northern Pacific Ry. Co. v. *Department of Public Works*, 268 U. S. 39.

Ohio Utilities Company v. *Public Utilities Commission*, 267 U. S. 359.
Interstate Commerce Commission v. *Union Pacific Railroad*, 222 U. S. 1. c. 547.
Bluefield Water Works and Improvement Co. v. *Public Service Commission*, 262 U. S. 679.
Vandalia Railroad Co. v. *Schnull*, 255 U. S. 113.
Union Tank Line Co. v. *Wright*, 249 U. S. 275.
Brooks-Scanlon v. *Railroad Commission*, 251 U. S. 396.
Northern Pacific Ry. Co. v. *North Dakota*, 236 U. S. 585.

VI.

The Rating Act (Sec. 6283, R. S. Mo. 1919) as now construed and applied by the Supreme Court of Missouri in the instant case, is unconstitutional, for each of the reasons assigned in the attack upon the rate reduction order.

1. The rating statute as written was not attacked by petitioners; but said statute as administered and justified by the Supreme Court of Missouri in the instant case was attacked as being in violation of the Fourteenth Amendment, in that it deprives petitioners of their property without due process of law (R. 35, 37, 621-2, 2216-17, 2263-4). In such a situation the constitutionality of the statute as construed in the instant case is presented as a federal question.

As this court said in *Myles Salt Co.* v. *Iberia Drainage District*, 239 U. S. 1. c. 484:

> "It is true that the law of the state as written is not attacked, but the law as administered and justified by the Supreme Court of the state is attacked and it is asserted to be a violation of the Constitution of the United States. The question presented is Federal and the motion to dismiss is denied."

To the same effect see *Reagan* v. *Farmers' Loan & Trust Co.*, 154 U. S. l. c. 390-391; *Greene* v. *Louisville & Interurban R. R. Co.*, 244 U. S. l. c. 507; *Raymond* v. *Chicago Traction Co.*, 207 U. S. l. c. 20; *Castillo* v. *McConnico*, 165 U. S. 674, and *Old Colony Trust Co.* v. *Omaha*, 230 U. S. 100.

2. If petitioners are right in any or all of their points of attack upon the constitutionality of the rate reduction order, then for the same reasons and in the same respects the rating act, as construed and applied, is unconstitutional. The two propositions, while distinct, go hand in hand.

3. The rating act as construed cannot be upheld on the ground that it is a condition upon which foreign corporations may do business in the state, "because the Legislature did not attempt to reach the result in that way. A company lawfully doing business in a state is no more bound by an unconstitutional enactment than a citizen of the state," (*Carroll* v. *Greenwich Ins. Co.*, 199 U. S. l. c. 409; *Cargill Co.* v. *Minnesota*, 180 U. S. 452).

No conditions can be imposed which are repugnant to the constitution of the United States. A state is without power to impose an unconstitutional requirement. (*Frost* v. *Railroad Commission*, 46 Sup. Ct. Rep. 605; *Terral* v. *Burke Construction Co.*, 257 U. S. 529; *Fidelity & Deposit Co.* v. *Tafoya*, 46 Sup. Ct. Ref. 331; *Western Union Telegraph Co.* v. *Kansas*, 216 U. S. 34).

VII.

If any single point of attack made upon the rate reduction order is sustained, the order must fall.

Upon the figures adopted by the opinion below the rate reduction order is sustained by the very narrow margin of $607,040. The amount involved in each one of petitioners' points of attack upon the order is greater

than that sum; so that if any one of petitioners' points is sustained, the order must necessarily fall.

To put it concretely: The opinion finds that after applying the 10% reduction, the petitioners on the volume of business in the test period would earn a profit of $7,287,209 (R. 3036), and that a reasonable profit on that volume of business would be $6,680,169 (R. 3035). So that the profit which the opinion says petitioners would earn with the reduction applied, is only $607,040 in excess of the amount which the opinion finds would have been a reasonable profit.

Each item complained of by petitioners involves more than $607,040. The adoption of the received and paid method of instead of the earned and incurred method, makes a difference of $10,351,324 in the tabulation of profit or loss (Plaintiffs' Exhibits 1359 and 1361 at R. 1925 and 1934). The inclusion of interest earnings from unearned premiums (investments) makes a difference of $2,301,132 (R. 3034-5). The rejection of excess commissions paid to St. Louis agents makes a difference of $2,496,715 (R. 3034-5). The rejection of war tax on Missouri premiums make a difference of $628,123 (R. 3034-5). Likewise, the fixing of $6,680,169 as the amount of a reasonable profit, without any allowance for the reserve, makes a difference far exceeding the narrow margin by which the rate reduction order is colorably sustained.

It therefore follows, as a self-evident mathematical fact, that if any one of petitioners' contentions is sustained, the rate reduction order is demonstrably confiscatory.

VIII.

In the exercise of a sound judicial discretion certiorari should issue.

We earnestly feel that the merits of our case should strongly appeal to the sound judicial discretion of this court. The questions involved are federal questions. They are of tremendous importance in Missouri and the numerous other states having statutes authorizing the regulation of insurance rates (R. 1128). As stated in the dissenting opinion (R. 3037), *"The questions involved are not only of present moment, but as time goes on will become increasingly important."* (Italics ours.) These questions have never been passed upon by this court. It is inevitable that sooner or later they must be decided here. This case presents them squarely.

Upon the principal question presented, the Supreme Court of Arkansas in *Bullion* v. *Aetna Insurance Co.*, 151 Ark. 519, 237 S. W. 717, has decided in favor of the earned and incurred method while the Missouri Supreme Court in the instant case holds contra. The same question is now pending before the Supreme Court of Kansas, and will inevitably arise in numerous other states having statutes authorizing the regulation of rates (R. 1128). It is appropriate that this court should authoritatively settle that question, as well as the other federal questions involved.

If the rate reduction order here involved should be finally sustained, the petitioners would be required to return to policyholders in Missouri approximately $7,000,000, representing the difference between the rates at which policies have been issued since November 15, 1922, and the rates fixed by the order. By stipulation the old rates have been collected and bond given to refund the excess if the order should be finally sustained (R. 1640-2).

If the Superintendent's order should be finally sustained, petitioners would suffer ruinous loss, not only in the amount of his gigantic refund, but in the further fact that they would be compelled in the future either to do business in Missouri at grossly inadequate and confiscatory rates, or to cease doing business in the state and thereby to lose their agency plants and established business, which are of great pecuniary value (R. 749, 1531-2, 1760-1, 1800, 1802-3), and which constitute property (*Denver* v. *Denver Water Co.*, 246 U. S. 178).

The Supreme Court of Missouri has decided the federal questions involved in a way plainly not in accord with applicable decisions of this court upon closely analogous questions.

We respectfully ask that certiorari issue as prayed.

Respectfully submitted,

CHARLES E. HUGHES,
ROBERT J. FOLONIE,
WILLIAM S. HOGSETT,
JOHN S. LEAHY,
ASHLEY COCKRILL,
Counsel for Petitioners.

APPENDIX.

The Missouri statute requiring insurance companies to set up unearned premium reserve as a liability is Sec. 6222, R. S. Mo. 1919, reading as follows:

> **"Sec. 6222. Reports, when to be made and what to contain.**—It shall be the duty of the president or vice-president and secretary or a majority of the directors of every insurance company organized under this article, or the laws of this state, or of the United States or any other state of the United States, doing the business mentioned in Section 6203, annually, on the first day of January, or within thirty days thereafter, to prepare under oath and deposit in the office of the superintendent of the insurance department a statement made up for the year ending the 31st day of December next preceding, showing: First, the amount of capital stock of the company, if it be a joint stock company, or if it be a mutual company, the amount of the face of the premium notes held by it, and the amount thereof remaining unpaid, specifying the amount constituting liens on property, and the amount of guarantee fund, if the company have such fund; second, the property or assets held by the company, specifying: First, the value of the real estate held by such company; second, the amount of cash on hand or deposited in banks to the credit of the company, specifying in what banks the same are deposited; third, the amount of cash in the hands of agents and in the course of transmission; fourth, the amount of loans secured by bonds and mortgages or by deeds of trust; fifth, the amount of notes and bills receivable, matured and remaining unpaid; sixth, the amount of notes and bills receivable maturing; seventh, the amount of other securities held by the company, specifying what they are and their cash value; eighth, the amount of debts considered bad or doubtful; third, the *liabilities* of the company, as

follows: First, the amount due or to become due to banks or other creditors; second, losses adjusted and due; third, losses adjusted and not due; fourth, losses unadjusted and in suspense and awaiting further proofs; fifth, *premium reserved or amount required to safely reinsure all outstanding risks, to be estimated by taking fifty per cent of the gross premiums on all unexpired fire risks that have less than one year to run, and a pro rata of all gross premiums on risks that have more than one year to run, with fifty per cent of the gross premiums on all unexpired inland navigation risks, and the whole amount of the gross premiums on all unexpired marine risks;* sixth, all other claims against the company; fourth, greatest amount insured in any one risk; fifth, the number of agents employed in this state or other states; sixth, the amount of outstanding risks and gross premiums received and receivable thereon at the date of each statement; seventh, the amount of receipts from all sources, and amount of expenditures for all purposes, including dividends for the last fiscal year preceding the date of the statement; and eighth, a statement of any other facts or information concerning the affairs of said company which may be required by the superintendent." (Italics ours.)

The Missouri statute prohibiting insurance companies from paying dividends out of unearned premiums is Sec. 6333, R. S. Mo. 1919, reading as follows:

"**Sec. 6333. Dividends shall not be made, when.**—*It shall not be lawful for the directors, trustees or managers of any insurance company to make any dividend, except from the surplus profits arising from their business,* nor for any company to solicit or do new business, when its assets are less than three-fourths of its liabilities. Any company violating the provisions aforesaid shall be subject to proceedings for dissolution. Each stockholder in a stock company receiving any dividend made in violation of the above provision shall be liable to

the creditors of such company to the extent of the dividend received, with compound interest on the same from the date of its receipt, as well as the cost of collecting the same, and the managers, trustees or directors assenting to the same, or any agent soliciting or doing new business, knowing or having reasonable cause to believe that such company is impaired as aforesaid, shall be deemed guilty of a violation of the provisions of this law, and shall be punished as by this chapter provided." (Italics ours).

The Missouri statute requiring insurance companies to report to the Superintendent of Insurance all such facts as the Superintendent may require, is Sec. 6281 R. S. Mo. 1919, reading as follows:

"**Sec. 6281. Companies to report premiums, losses, expenses and earnings on unearned premiums.**—Every stock fire insurance company licensed to do business in this state shall annually before March 1st of each year report to the superintendent of insurance the total amount of business in this state for the preceding year. In reporting expenses, it shall separately state its disbursments and expenses for:

(a) Commissions paid to agents.
(b) Salaried paid.
(c) Taxes paid.
(d) Other underwriting disbursments.

Each such company shall also report the total amount of its earnings on unearned premiums, *and such other matters as the superintendent of insurance may require*. And all insurance adjusters, whether employed regularly on a salary, or acting in the capacity of adjuster by special contract, for or on account of any fire insurance company, shall be considered an employe of said company and be subject to regulation and requirements of the fire insurance laws of Missouri as if they were originally commissioned agents therefor."

The provision of the income tax law applicable to insurance companies appears as Sec. 246 in the Revenue Acts of November 23, 1921, June 2, 1924, and February 26, 1926. Section 246 is identical in each act except as to dates and numbers of other sections referred to therein. Sec. 246 of the Revenue Act of November 23, 1921, is as follows:

> **"Other insurance companies; taxes imposed upon in lieu of other taxes; gross income; net income; investment income; underwriting income; premiums earned on insurance contracts during the taxable year; losses incurred; expenses incurred.—**
>
> (a) In lieu of the taxes imposed by Sections 230 and 1000, there shall be levied, collected and paid for the calendar year 1922, and for each taxable year thereafter, upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:
>
> (1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by Section 230;
>
> (2) In the case of such a foreign insurance company the same percentage of its net income from sources within the United States as is imposed upon the net income of other corporations by Section 230.
>
> (b) In the case of an insurance company subject to the tax imposed by this section—
>
> (1) The term 'gross income' means the combined gross amount earned during the taxable year, from *investment* income and from *underwriting* income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;
>
> (2) The term 'net income' means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by Section 247;
>
> (3) The term 'investment income' means the gross amount of income earned during the taxable year from interest, dividends and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) *The term 'underwriting income' means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;*

(5) The term 'premiums earned on insurance contracts during the taxable year' means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) The term 'losses incurred' means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) The term 'expenses incurred' means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by Section 247. (42 Stat. 262)."